$2.50 a copy

Regulation

May/June 1980 AEI Journal on Government and Society

ON THE CORPORATE DEMOCRACY ACT

Mark Green Ralph K. Winter
Murray Weidenbaum

The Perils of Risk Avoidance

Paul Johnson

Competition and Health Care

Clark Havighurst Glenn Hackbarth

Bubbles and Efficiency

M. T. Maloney
Bruce Yandle

Frustrating Business Mobility

Richard B. McKenzie

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

It's your business to read REGULATION.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Regulation

May/June 1980 AEI Journal on Government and Society

Competition of ideas is fundamental to a free society

Publisher, *William J. Baroody, Jr.*

Co-Editors, *Antonin Scalia* and *Murray L. Weidenbaum*

Managing Editor, *Anne Brunsdale*

Board of Editors, *Irving Kristol, Robert Bork, Jeane J. Kirkpatrick, Marvin Kosters, Paul MacAvoy, James C. Miller, Austin Ranney,* and *Laurence H. Silberman*

Senior Editor, *James M. Wootton*

Associate Editor, *Sharon Shepherdson*

Contributing Editors, *Samuel Eastman, Robert Helms, Mitchell Knisbacher, Marvin Kosters, Michael Malbin,* and *Jack Meyer*

Editorial Assistant, *Cindy L. Hussmann*

Production Editor, *Donna Spitler*

Designer, *Pat Taylor*

Editorial Consultant, *Hunter C. Harrison, Jr.*

REGULATION, *May/June 1980, Vol. 4, No. 3. Published bimonthly by the American Enterprise Institute for Public Policy Research.* *Copyright 1980 American Enterprise Institute.* *Subscription rates: $12 for one year, $22 for two years (add $2 per year for foreign subscriptions). Single copy price, $2.50. Information on bulk orders or multiple subscriptions available on request. Editorial and business offices: c/o AEI, 1150 17th Street, N.W., Washington, D.C. 20036. Send changes of address and all subscription correspondence to Circulation Department, c/o AEI, same address.*

Second-class postage paid at Washington, D.C.

"American Enterprise Institute" and "AEI" are registered service marks of the American Enterprise Institute for Public Policy Research.

LETTERS 2

PERSPECTIVES on Current Developments 5
Government Regulation of Government: The USPS, the PRC, and the FCC
Two Lies Are Better Than One
Reforming Trucking Regulation
Congressional Control
Diesel Automobiles—A Mixed Blessing?
In Brief—

VIEWPOINT: The Perils of Risk Avoidance 15
Paul Johnson

ON THE CORPORATE DEMOCRACY ACT
The Case for Corporate Democracy 20
Mark Green
What's Not in a Name 26
Ralph K. Winter
What Is True Corporate Responsibility? 30
Murray L. Weidenbaum

FRUSTRATING BUSINESS MOBILITY 32
Richard B. McKenzie

COMPETITION AND HEALTH CARE—Planning for Deregulation 39
Clark C. Havighurst and *Glenn M. Hackbarth*

BUBBLES AND EFFICIENCY: Cleaner Air at Lower Cost 49
M. T. Maloney and *Bruce Yandle*

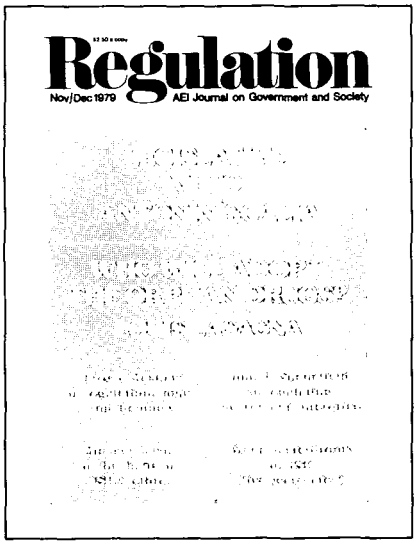
READINGS of Particular Interest 53

ISSN 0147-0590

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.



Adopting Orphan Drugs

TO THE EDITOR:

Louis Lasagna's article, "Who Will Adopt the Orphan Drugs?" (November/December), correctly points out that the FDA's demands for costly long-term preclinical and clinical studies have served to deter research, development, and manufacture of "public service" or orphan drugs by pharmaceutical companies. As he concludes, the FDA's regulatory processes and the pharmaceutical companies' goals are not compatible with the development of orphan drugs.

Along with Dr. Lasagna, I am not optimistic that the problem of orphan drugs will be solved. My attempts to interest pharmaceutical companies, government agencies, and the private sector in assisting in the development of L-5-hydroxytryptophan for myoclonus have been futile because of the uncompromising positions and self-interests of the parties involved. By definition, orphan drugs are unprofitable and hence unattractive to pharmaceutical companies whose interest in development and manufacture of new drugs is proportional to their anticipated financial returns. After all, the companies' major obligation is to stockholders, not patients. As the costs of FDA regulations increase, the number of orphan drugs and orphan diseases will increase, which portends even greater problems for the future.

The FDA's position is that its duty is to *regulate* drugs for safety and efficacy, not to facilitate research, development, and distribution of either profitable drugs or those with little commercial interest. As for the National Institutes of Health, the high costs of drug development have kept it from getting involved with this problem, except for the heavily funded National Cancer Institute and the epilepsy branch of the National Institute of Neurological and Communicative Diseases and Stroke. Moreover, little help can be expected from consumer organizations such as Dr. Sidney Wolfe's Health Research Group. These organizations are predominantly concerned about the safety of new drugs and favor premarketing tests and safeguards even more stringent than those which orphan drugs cannot presently meet. Finally, a succession of committees, task forces, and legislative proposals have produced at best only hints of possible solutions and vaguely defined incentives.

If we agree that the present system limits drug development to only profitable diseases and ignores scientific leads for orphan diseases, and if we concur that this is unfair and contrary to the public interest, then stronger, more concrete measures are needed. These could include mandatory government contracts, increased NIH support for drug development, or making orphan drug development one requirement for the licensing of ethical pharmaceutical companies.

Perhaps the most encouraging recent development is the concerted lobbying effort on the part of the members of voluntary health organizations such as the Committee to Combat Huntington's Disease, the Epilepsy Foundation of America, the Tourette Syndrome Association, the National Myoclonus Foundation, and others. Congresswoman Elizabeth Holtzman (Democrat, New York) is one legislator who has responded to their appeal and who is formulating legislation which should offer more direct and precise solutions to this problem.

Melvin H. Van Woert, M.D.,
Mount Sinai School of Medicine

TO THE EDITOR:

Dr. Louis Lasagna's article certainly points up the despair of those today who must face death prematurely, for want of effective treatment.

We seem to have forgotten the morality of cure—for we dwell instead on care. Care is certainly kind. Cure, however, is kinder. Ultimately, all patients want nothing more than to be rid of their disease. They care little for insurance that permits them to suffer the disfiguration of arthritis or the painful agony of oncoming death from cancer.

The ridding of disease can come only through innovation—the genius which discovers the cure. What are the ingredients of innovation in medicine? They are ideas and the testing of these ideas in medicine, through clinical research. Block the transition of the ideas to their clinical testing and innovation suffers. This is precisely what is happening today and threatens to continue to happen. Barriers ranging from regulatory to legal to moral have virtually blocked the entrepreneur in the pharmaceutical world from clinically testing his ideas.

With natural substances the problem is even more critical. Because of the nature of our patent laws, strong patents are easier to obtain for artificial molecules synthesized by chemists than for natural substances. The economics, therefore, of spending millions of dollars to develop safe natural substances is not nearly so promising as that of very strange molecules. Thus, in an irresponsible way, the Congress continues to encourage production of artificial molecules that assail the organ systems of our bodies and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

cause a myriad of adverse effects ranging from generalized weakness to cancer.

The human body has a wonderful track record of combatting disease from the time of conception to our final hour. Does it not make sense to harness those substances that continually and successfully fight off the daily enemy, the invaders of the body and the mind? The greatest breakthroughs in medicine—steroids, digitalis, antibiotics, vaccines, and so on—all involve natural substances, not some new molecule conceived by chemists.

As Dr. Lasagna pointed out, it was thirteen long years from the time when I first postulated that carnitine would have a beneficial effect in heart disease (idea) to the testing of the hypothesis clinically (clinical research). After the thrill of the clinical confirmation of the idea came the depression of the economics of medicine. Carnitine is a natural substance with much promise but weak patents. This unfavorable combination is not sufficient to arouse the interest of the U.S. pharmaceutical industry.

The Congress, spearheaded by Senator Kennedy, increasingly blocks innovation in medicine by preaching the politics of care. Congress, therefore, is without doubt the greatest enemy of the patient. Perhaps a wiser presidential candidate will dare to raise the issue of "cure" instead of "care" to the public. What better way than to begin with nature?

Stephen L. DeFelice, M.D.,
President, Biocarn Ltd.

TO THE EDITOR:

Louis Lasagna's article is a clear exposition of a critical unsolved problem. He suggests a number of solutions: (1) increased activity by the federal government, (2) less stringent regulations for the release of orphan drugs, and (3) patent protection, as well as market exclusivity for venture drug-development firms.

Rather than expand government support of drug development, I would prefer the approach of greater participation by the pharmaceutical industry. My suggestion is that a group of the major pharmaceutical companies, or perhaps the Pharmaceutical Manufacturers Association, appoint a panel of distinguished scientists outside of the industry to study the problem and to invite scientists working with potentially useful orphan drugs to so advise the panel. The panel could then review each case to determine whether available channels had been exhausted, and if not, to guide the investigator to a company with possible interest in the drug. If no takers were found, the panel would then review the merits of the investigators' proposals for their respective drugs and compile a list ranked according to merit. The companies represented in the consortium then would decide, possibly on a rotational basis, how many orphan drugs they could assist in developing.

This plan has several advantages. First, an estimate of the numbers of orphan drugs requiring and deserving development would be obtained. Second, an enthusiastic investigator would have the opportunity of presenting his or her drug to a peer review panel outside the industry, thus reducing criticism of the industry when drugs are refused, as many must be, on the basis of merit. Third, if the number of meritorious orphan drugs were found to be large, then a better case could be made for pressing for the long-range solutions suggested by Dr. Lasagna. Fourth, like dopamine, some of these drugs ultimately may prove to be profitable. The companies involved in the consortium could consider plowing back profits into future development.

There will undoubtedly be many objections to this proposal. I would be interested in knowing them.

Finally, Dr. Lasagna and I agree that there is a certain lack of imagination on the part of industry. I must, however, partially disagree with his statement depicting the psychology of the house scientist: "If a company's scientists did not develop a particular idea or seek out a particular product on their own, it is not worth considering." In my opinion, orphan drugs discovered in industry are rejected also and for the same reason as drugs outside of industry—cost. At best, it is extremely difficult to estimate the market of a totally innovative product and, in view of the extraordinarily high cost of development, the refusal by the pharmaceutical industry to proceed with some of these drugs is certainly understandable. This brings us to perhaps the most important argument of Dr. Lasagna's paper: a long-term solution will require a more rational and economical path for development of new drugs.

Leon I. Goldberg, M.D., Ph.D.,
The University of Chicago

TO THE EDITOR:

Dr. Lasagna, in his usual lucid and incisive style, calls attention to a major deficiency in drug development in our country. He correctly points to the development of new anticancer drugs as an area where the government played a major role. That program, begun in approximately 1956, has proven enormously successful: at least thirty clinically useful anticancer drugs are commercially successful and are now available to physicians.

There remain, however, major areas of drug development where commercial potential is limited and the needs of individual patients and their physicians are great. These are the so-called orphan drugs. For example, in our own clinic we have found that etiocholanolone is highly effective at mobilizing granulocytes into normal donors' peripheral blood, increasing the efficiency of granulocyte collection by approximately 100 percent. This drug is no longer available to us or to the donors and we have to expend enormous amounts of time and energy using other drugs that are less effective.

Scientists, physicians, and patients alike have come to the view that FDA regulations are now clearly oppressive. As Dr. Lasagna points out, the enormously increased cost of complying with FDA requirements has swelled the number of drugs that fall into the orphan category. It seems to me that the federal government now has an opportunity to undo some of the harm it has inadvertently done to people who desperately need these drugs. The agency could do this by providing direct support to the pharmaceutical industry for the manufacture and distribution of precisely these orphan drugs. As with the cancer drug-development program, when the potential usefulness of an agent is clearly demonstrated, the federal government could support its preparation and manufacture until the scientific community determines the agent to be (1) of proven value and potentially financially successful, whereupon the drug industry could assume responsibility for it; or (2) ineffective, unnecessary, or superseded by another drug, in which case it could be discontinued.

It is time, I believe, for the public to call upon its government to implement such a program. In my personal view, the FDA should be given the responsibility and opportunity to break with its negativism

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and to contribute and stimulate the development of needed orphan drugs.

Emil J. Freireich, M.D.,
M. D. Anderson Hospital
and Tumor Institute

TO THE EDITOR:

Dr. Lasagna is correct that there *are* orphan drugs, as was clear from my previous vantage point as a drug regulator. More important, there are orphan patients suffering from illnesses rare enough so that there is little commercial interest in finding a drug to cure them.

Epileptics are among those patients, and there is indeed a program for developing antiepileptic drugs at the National Institute of Neurological and Communicative Disorders and Stroke. But it is not only a program in theory, as the article suggests, but a practical and remarkably effective one, that has played a key role in getting three new antiepileptic drug applications approved in the United States since 1974, after a hiatus of fourteen years without even one new primary antiepileptic being introduced in this country. Intriguingly, this program is only one of eight or more such government programs, proceeding quietly with varying success—ranging from the NASA-like cancer drug program to a program aimed at new iron chelators for Cooley's anemia patients.

Dr. Lasagna made two arguments deserving of qualification. One relates to the difficulties in developing new drugs. His anecdotes of orphan drugs could be multiplied many times, since for each marketed drug there may be 3,000 compounds that were orphaned, or even stillborn, in the development process. That's the nature of drug development and nobody says it's easy. Of the drugs dropped along the road, some have had more vociferous supporters than others. The examples he selected may be major improvements, or they may turn out to be just clever ideas that did not work. For example, the facts are not all in on 5-HTP, even though it has seemed to help a few patients a great deal.

To move on to the second argument, I do not believe the picture will be as black as Dr. Lasagna does once the facts *are* in. In the past, a number of orphan drugs have found a home once a quantum of evidence was reached. Dr. Lasagna and the FDA differ on what the quantum is, but the FDA is not alone in believing toxicity testing and controlled trials are valuable before distributing a compound nationally. Although the FDA has at times been unnecessarily rigid, it has played a major role in facilitating marketing of orphans like L-dopa and nitroprusside. As for 5-HTP, Dr. Van Woert is continuing his studies (with government support). That is not to say there aren't many problems left to solve, but I do not believe we need to share all of Dr. Lasagna's pessimism.

Barrett Scoville, M.D.,
National Institutes of Health

LOUIS LASAGNA responds:

Dr. Goldberg's comments, like those of the other correspondents, are well taken. But the "not invented here" syndrome is not my own assessment of the state of affairs, but what "some disgruntled scientists have begun to refer to cynically" as a cause for orphanization.

Reforming OSHA

TO THE EDITOR:

Michael Levin's "Politics and Polarity—The Limits of OSHA Reform" (your November/December issue) is a refreshingly frank and insightful analysis of the problems many of us in Congress have faced as we have tried to improve OSHA. As Mr. Levin points out, there is a clear need for an effective federal program to improve worker safety and health, and OSHA has not met that need adequately. Indeed, the agency has become probably the most despised federal agency in existence. Moreover, plans to seek reform have been derailed by the bitter (or, in Mr. Levin's words, "almost petrified") polarization of management and labor—and I might add, of many members of Congress.

Your readers may be interested in a concrete reform effort now under way in the Senate. On December 19, I introduced the Occupational Safety and Health Improvements Act of 1980 (S.2153, cosponsored by a broad bipartisan coalition that includes Senators Harrison A. Williams, Jr. (the principal author of the original OSHA bill in 1970), Frank Church, Alan Cranston, and Orrin Hatch. This bill would concentrate OSHA's safety enforcement activities on workplaces having poor injury records and would create incentives for industry itself to reduce occupational injuries and illnesses. In short, the legislation seeks to shift OSHA's role from that of a policeman to something more like that of a cooperative partner in improving workplace safety and health. Under the bill, workplaces with good safety records would be exempt from most safety inspections and, in addition, those that maintained an active safety program (including outside consultation and a safety committee) would also be exempt from most civil penalties for safety violations.

These proposals are similar to suggestions made in Mr. Levin's article and in the report of President Carter's Interagency Task Force on Workplace Safety and Health, of which Mr. Levin was deputy director. Now, for the first time since OSHA was created, we have significant movement toward depolarizing OSHA and building a consensus for meaningful reform.

Richard S. Schweiker,
United States Senate

Government Enterprises

TO THE EDITOR:

John Shenefield deserves credit for calling attention to the federal government's growing propensity to blunder into direct control of formerly private enterprise. But he should pick his quarrel with the blunders. Instead, he presents an argument against government enterprise in general. His case rests on three points. Of these only the last is valid, and when taken alone it points to a different conclusion.

Shenefield's first point is that government enterprises skew pricing signals in undesirable ways, whereas in the competitive private sector "the traditional assumption has been that . . . price will tend to be aligned with marginal cost." In fact, marginal cost pricing neither is nor can be an authentic policy objective. Shenefield concedes that stringent conditions must be met before marginal cost pricing will actually prevail. He ignores the further conditions that must apply for it to be desirable that marginal cost pricing prevail. These are set out in J. de V. Graaff's classic *Theoretical Welfare Economics*, Chapter 10: "The conditions which have to be met before it is correct (from a welfare standpoint) to set price equal to marginal cost in a particular industry are so restrictive that they are unlikely

(Continues on page 59)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Perspectives
on current developments

Government Regulation of Government: the USPS, the PRC, and the FCC

The Governors of the United States Postal Service met on June 3 and again failed to take action on the pending recommendation of the Postal Rate Commission concerning the Postal Service's commencement of electronic mail service. The matter has a long and tortuous history, which is worth pursuing for the light it sheds upon the regulatory process in general and the functioning of the 1970 Postal Reorganization Act in particular.

The U.S. Postal Service has been slow to enter the telecommunications field. Until recently, its only direct involvement was the delivery of Mailgrams, a service marketed and controlled by Western Union. This began to change under Postmaster General William Bolger, who took office in March 1978. Bolger favored an electronic role for the USPS to offset expected declines in conventional mail volume, and moved forward with three new service proposals—Intelpost, EMSS, and E-COM. The first two are *facsimile* systems designed to transmit anything that appears on a piece of paper. Intelpost, envisioned as an international service relying on satellite circuits, is currently bogged down by the Federal Communications Commission's rejection of tariff filings from RCA Global Communications and TRT Telecommunications. EMSS, a futuristic domestic service still in the planning stage, would equip selected post offices across the country with electronic devices to transmit and receive images, using satellite circuits for interconnection.

Unlike EMSS and Intelpost, E-COM is a plain old *alphanumeric* service, limited to the transmission of messages that can be typed on a standard keyboard. It is intended to provide the high-volume mail user with speedy, low-cost delivery of computer-generated messages —principally dunning notices and other standard high-priority messages.

E-COM is a so-called Generation II electronic message service, meaning that both the input and the long-distance transmission are electronic, but the output is hard copy ready for hand delivery by the Postal Service. Generation I services involve hand delivery both to and from the post office, with electronics providing only the long-distance transmission. Generation III is electronic from sender to receiver.

According to senior USPS officials, the Postal Service wishes to enter the markets for Generation I and II services in order to take advantage of its existing nationwide delivery network, and has no interest in Generation III. However, the communications industry fears that USPS will initially cross-subsidize Generation I and II service so as to establish a foothold in the electronic market; and they fear that it will then use its existing electronic capability as a plausible reason to expand into Generation III—which, they predict, will soon consign Generation II to the realm of the Pony Express. It is the case that the $1.7 billion communications system on the drawing board for EMSS, which USPS officials describe as strictly Generation II, could provide Generation-III service with almost no modification.

Against this background, it is clear why the E-COM proposal was seen from the beginning as a precedent-setter. Its outcome would shape the Postal Service's relationship with both the communications industry and the PRC. It would also broadly determine the respective spheres of jurisdiction of the PRC and the FCC regarding electronic mail.

So much for the commercial and technological background. Now for the regulatory structure within which the E-COM case will be resolved: The Postal Reorganization Act made the U.S. Postal Service an independent establishment of the executive branch, headed by an eleven-member Board of Governors com-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

posed of nine governors (appointed by the President), the postmaster general (appointed by the Governors), and the deputy postmaster general. The act also established the Postal Rate Commission as an independent agency with a unique regulatory relationship to its sole subject industry. Before any changes in postal rates or mail classifications can take effect, the Postal Service must submit its plan to the PRC for that agency's "recommended decision" in accordance with rather vague criteria specified in the statutes—for example, "the establishment and maintenance of a fair and equitable classification system for all mail." (A complication that need not be pursued here is that the commission may also issue a recommendation upon its own initiative, unprompted by any proposal from the USPS.) The recommended decision is to be issued after a record hearing has been accorded "to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public." And the recommended decision is addressed to —of all people—the nine governors of the Postal Service itself. They may reject the recommendation—in which event the matter ends there, and the rate or classification revision desired by the Postal Service does not take effect. The Governors may, on the other hand, approve the decision, in which case aggrieved parties may appeal to the courts; or they may allow the decision "under protest," in which case aggrieved parties and the Governors themselves may appeal to the courts. Finally, the Governors may reject the decision but cause the Postal Service to resubmit its request—in effect remanding the matter to the PRC for reconsideration. In the latter event the PRC must, after reconsideration, issue a "further recommended decision," which again is submitted to the Governors. This time, however, the Governors have an additional option: if they are unanimous on the matter and if they find (among other things) that the PRC's further recommended decision does not provide rates adequate to balance the books, they may *modify* the commission's decision and implement their own proposal—which will, again, be subject to judicial review at the instance of aggrieved parties.

It should be apparent that this strange balance-of-power arrangement between the PRC and the federal establishment it is supposed to regulate contains the seeds of bitter bureaucratic fruit; and the E-COM case appears to be the first large harvest. The sequence of events has been as follows: The Postal Service submitted its E-COM proposal to the commission in September 1978, about six months after Bolger took over as postmaster general. Under that proposal, Western Union was to procure and operate the data-processing and telecommunications equipment, and USPS was to handle only printing, enveloping, and final delivery. Since Western Union was willing to support the service for a trial period on its in-place Mailgram equipment, regulatory approval was all that was required to go forward.

To the surprise of USPS management, the PRC decided to give the proposal a hard look, following objections from the Department of Justice, the National Telecommunications and Information Administration, and the Officer of the Commission (referred to above). Hearings were quickly begun, focusing on charges that the system design and the use of a sole-source contractor would have anticompetitive effects on the market for communications services.

At about the same time, another regulatory complication emerged. Two challenges to the E-COM proposal had been filed with the FCC—which has, of course, as much apparent jurisdiction over electronic telecommunications as the PRC has over the mail. The commission, responding to Graphnet's request, ruled in August 1979 that E-COM constituted a communications service and therefore was concurrently subject to FCC regulation. And the FCC's Common Carrier Bureau examined, and rejected as discriminatory on its face, the tariff application it had required Western Union to file.

With the Postal Service in trouble on two regulatory fronts, the White House took action. In late 1978, an eleven-agency task force was formed under the direction of Domestic Policy Adviser Stuart Eizenstat. That effort culminated in mid-July 1979 with the President's supporting Postal Service involvement in electronic mail, but attaching eight restrictions deemed necessary to ensure free and open competition in telecommunications. While Postmaster General Bolger publicly concurred with the President's position, the Postal Service argued before the PRC that the eight conditions were not applicable to E-COM—and took the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In Brief-

Soviet Ammonia—Act II, Scene I. In our January/February issue we described the International Trade Commission's decision curtailing imports of Soviet ammonia—which was overturned by a free trade presidential decision—which was in turn soon followed by a presidential change of heart attributable to Afghanistan. The outcome at that time was a White House request for a further ITC investigation, enabling the President to impose a temporary import quota. We noted that it would be ironic if the ITC were to change its mind—deciding for free trade now that the White House clearly wanted to keep the stuff out.

That is exactly what happened. On April 11, the new member of the five-member commission sided with the two dissenters from the earlier decision, voting to let Soviet ammonia in. The next scene in this farce should see the President reversing *his* original decision, again overturning the ITC—this time for coming out the way he told it to come out the first time. But, alas, negative ITC decisions are not reviewable by the President. Still, a final scene may yet be written, for the House is considering a bill to raise the ammonia tariff for Communist nations.

FEC Gets Trimmed. On February 5, the U.S. Court of Appeals for the Second Circuit dismissed the Federal Election Commission's suit against the Central Long Island Tax Reform Immediately Committee (CLITRIM). In 1976, CLITRIM had spent $135 to publish a newsletter in which it listed the votes of the local member of Congress on twenty-four issues, and described the votes as being for either "higher taxes and more government" or "lower taxes and less government." The newsletter never mentioned that the congressman was up for reelection, never identified his political affiliation, and never referred to his opponent. Despite this, the FEC ruled that CLITRIM had been "expressly advocating the election or defeat of a clearly identified candidate" within the meaning of the Federal Election Campaign Act Amendments of 1976, and thus the reporting and disclosure requirements of the law applied.

A unanimous court of appeals judged the FEC's position "totally meritless." The law as written in 1974 had required organizations to report expenditures of more than $100 "for the purpose of . . . influencing" an election, but that language was changed in 1976 after the Supreme Court found, in *Buckley* v. *Valeo*, that the reporting requirement must be limited to expenditures for the express advocacy of a candidate's election or defeat if it was to avoid being unconstitutionally vague. "Contrary to the position of the FEC," the appeals court said, "the [new] words 'expressly advocating' mean exactly what they say."

Chief Judge Kaufman, joined by Judge Oakes, filed a concurring opinion of even broader sweep—suggesting that *Buckley* did not go far enough in striking down aspects of the Federal Election Campaign Act that infringe on First Amendment guarantees: "It is incongruous to compel defendants to convince a court that they have not dared to 'expressly advocate' the defeat of a candidate for public office. I had always believed that such advocacy was to be applauded in a representative democracy. . . . [C]ampaign 'reform' legislation of the sort before us is of doubtful constitutionality. . . .

Goals + Sanctions = Quotas. For those who are in any confusion about the difference in coercive effect between lawful affirmative-action goals and unlawful affirmative-action quotas, the Justice Department's notion should be apparent from Attorney General Benjamin R. Civiletti's April 9 address at Howard University:

"When I became Attorney General, in August of 1979, a survey of the top positions in the Department of Justice showed 14 women, 16 Hispanics, 41 blacks, 3 native Americans, and one Asian American in those positions. I have made it clear since I took the job that I intend to double those figures before I leave, given some reasonable time. To accomplish that, I have taken a number of specific steps. I have instructed each component of the Department to develop by May 15, goals and time tables for increasing the number of minority, women and handicapped employees in each category of employee within the component.

"Senior Executives Service members . . . will be evaluated on their success in meeting their component's goals, and continued employment, promotion and raises depend on these evaluations."

Presumably the matter has been made just as clear to all employees, and prospective employees, of the Department of Justice.

FCC's assertion of jurisdiction to court.

Meanwhile, back at the PRC hearings, the Officer of the Commission (OOC) was urging an "alternative design" for E-COM, one that would permit competition in the communications segment of the service. Whereas the Postal Service proposal required that all data and message processing be performed at the Western Union facility in Middletown, Virginia, the OOC design would give the Postal Service the capability to receive messages from multiple communications common carriers at each electronically equipped post office, enabling mail users to send their messages directly to the Postal Service.

Aside from the savings and wider variety of service offerings likely to be realized as a result of competition in the communications segment, the OOC's equipment configuration would be considerably less costly than that pro-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

posed by the Postal Service. This would be partly the result of using state-of-the-art technology instead of Western Union's vintage computers. But considerable economies would also result from decentralized processing: the USPS proposal required two transmissions of each message—first from customer to Western Union and then from Western Union to an electronically equipped post office—while the OOC design required only one—from customer directly to the post office.

In December 1979 the PRC issued its recommended decision, rejecting the Postal Service's proposal and adopting the OOC's pro-competitive version of E-COM. The commission took note of the FCC's policy of encouraging competition in the market for communications services, and found that several carriers had an existing or potential capability to provide the communications support. It therefore required the Postal Service to encourage interconnection by all communications common carriers.

Perhaps even more important, the PRC's decision cut the Gordian knot that had bound E-COM for eighteen months. By separating the electronic function of transmitting messages from the functions of converting messages to hard copy and physically delivering them, the PRC permitted a rational division of regulatory jurisdiction between the FCC and itself and allowed competition in the electronic segment while not disturbing the Postal Service's statutory monopoly over first-class mail delivery. (The same separation, of course, renders the USPS's entry into Generation III less likely.) In addition, the PRC found that the Postal Service's specifications had arbitrarily limited consideration of competitive alternatives and that its evaluation of carriers other than Western Union had been "pro forma."

The commission's decision received widespread support. However, on February 22 of this year the Governors of the Postal Service rejected it and sent it back to the PRC for reconsideration. They accepted the "basic structure" of the commission's decision, agreeing there should be "full and free competition in the telecommunication's segment of E-COM"; but they requested revision or clarification of five points —none of which (the PRC pointedly observed) would have prevented E-COM from being implemented immediately. On April 8, the PRC issued its further recommended decision, making the one clarification the Governors had requested. This was by no means insignificant, since it acknowledged that the Postal Service could, as far as the PRC was concerned, contract for its own telecommunications link in conjunction with private carriers—though the PRC noted that FCC approval might be needed for this purpose. (The Postal Service is currently contesting in the courts the FCC's asserted jurisdiction over the service's telecommunications activities.) But the PRC declined to make two of the revisions that the Governors had requested and left the other two for determination after further hearings.

The two requested revisions that were declined convey some of the flavor of the institutional turf-protection that is going on here. The Governors had requested, and the PRC declined to provide, authorization for the Postal Service to require "assurances of service quality, duration and scope" from carriers providing service to electronically equipped post offices. Anyone familiar with regulation—and with telecommunications regulation, in particular—should be aware that the power to establish quality standards amounts to the power to restrict competition. The PRC's refusal to provide this authority to the Postal Service was based principally upon the ground that it belonged to the FCC. The other declined revision was a request by the Governors that the PRC eliminate the description of its approval for E-COM as being on an "experimental" basis and, more specifically, eliminate the approval termination date of October 1, 1983. This device, of course, gives the PRC substantial continuing power over the field. Without it, the PRC could, on its own initiative, make recommendations for revision in the structure of E-COM—but unless the Governors approved those recommendations, the status quo would continue. With the approval cutoff date, however, it is the PRC that has the leverage: unless the Governors accept its 1983 decision, E-COM will come to a halt.

As noted at the outset of this discussion, the Governors—although long anxious to initiate an electronic mail service—have still failed to act upon the PRC's April 8 further recommended decision, despite the fact that they have accepted the PRC's basic pro-competitive approach. Some expect the Governors to give their approval after a delay long enough to call attention to their veto power and display

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

their pique. That is probably an accurate prediction, but institutional incentives render it somewhat less than certain. The PRC's seizure of the lead role in this matter has come as a surprise to most observers, and a shock to the Postal Service. An agency whose only explicit dispositive authority is to prevent mail rate and classification changes and post office closings has ended up drawing the jurisdictional demarcation between postal regulation and telecommunications regulation, assessing the relative advantages of open competition, and evaluating the technological and commercial feasibility of such electronic esoterica as multiplexing and archiving.

The PRC has, in short, effectively prescribed the nature and extent of Postal Service entry into this new field. That the commission should turn out to have so much power should come as no surprise to private companies in the regulated sector, who know the regulatory corollary to the ancient maxim: he who approves the piper's rates and classifications calls the tune. And private regulated companies must take a certain perverse delight in the spectacle of a government enterprise's learning this lesson firsthand—and getting caught, to boot, in a classic regulatory cross fire from the PRC and the FCC.

In short, the PRC has done no more than engage in normal and quite predictable regulatory behavior. But that is small comfort to the Postal Service, which is, after all, a government agency with the supposed immunity from management-by-regulation which that entails. From the Postal Service's point of view, establishing the level of PRC intervention that it is willing to tolerate may be more important than prompt commencement of electronic mail service. Indeed, it may even be more important than ultimate commencement of electronic mail service if the terms of such commencement are to be so limited (as they now are) as to prevent the Postal Service's participation in monopoly profits for the telecommunications segment.

It should be recalled that, upon receipt of a further recommended decision, the Governors have the option not merely of rejection but also of revision. One suspects that their long delay may be attributable to the attempt to compile the unanimous vote necessary for such purpose—and (what is perhaps more difficult, if not honestly impossible) the attempt to devise a justification for revision that is based, as by law it must be, upon inadequacy of revenues derivable from the PRC proposal.

Given appropriate odds, it would not be foolish to bet against E-COM. Fortunately, perhaps, the public's stake in all of this may be less than it seems. A private firm, Tymnet, Inc., has just announced plans to offer a service similar to E-COM. The plan envisions that, after messages are transmitted electronically, printed and enveloped, they will be dropped at the local post office for delivery as first-class mail. Under that system, the Postal Service's function will be clearly limited to sorting and hand delivery. That may be where it will end.

Two Lies Are Better Than One

Ralph Nader and Public Citizen (an organization formed under his auspices) have recently been urging that corporations be required to file with the Securities and Exchange Commission any corporate statement made to agencies or courts claiming substantial detrimental effects from proposed or implemented regulations—that is, costs exceeding 2 percent of the corporation's average income or loss for the last three years. The alleged practice to which the proposed requirement is addressed is the "crosstown hypocrisy" of forecasting dire effects from new regulations before the agencies and the courts, while understating or disregarding such effects in reports to the SEC and shareholders. "Someone," says Nader, "is being lied to."

On its face, the proposal seems reasonable enough. Surely, Truth is One, and corporations should not be permitted to dissect it this way. Of course the proposal is not primarily designed to protect shareholders. Any inconsistency between SEC filings and other corporate statements already risks legal liability; and if it were just a matter of bringing such inconsistencies to the attention of unalert class-action lawyers, there would be little reason to focus exclusively upon court and agency rulemaking filings: *all* corporate statements concerning future prospects should be sent to shareholders and the SEC. Obviously, then, Mr. Nader's main purpose is to protect the courts and the agencies from "crosstown hypocrisy," an objective

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

that is no less laudable simply because it is less expansive. Specifically, it is thought that Cassandra-like warnings of impending doom will be less frequent in rulemaking proceedings (and in court cases reviewing rulemaking) if corporations know that their pessimism must be shared with investors. Thereby, it is thought, accuracy of argumentation and (*pari passu*) accuracy of determination will be fostered.

The proposal merits serious consideration, because if it is sound it should have useful application in many other fields. To take only one of many possible examples: plaintiffs in tort suits might be required to present their courtroom descriptions of their disabling injuries to all prospective employers. But alas, in this context the fallacy of the proposal becomes evident. The fundamental premise of the adversary system, which governs our judicial and rulemaking proceedings, is that the truth can best be determined by hearing both sides of the case *put in their most favorable light* by zealous spokesmen for each. Lawyers spend years acquiring the skill of putting the best possible face upon their clients' case. To accuse a litigating lawyer of making a balanced, objective, even-handed, impartial presentation is high condemnation, if not actionable libel. This same adversarial premise, needless to say, does not govern SEC filings, which are supposed to represent objective assessment rather than partisan argument. Thus, to perceive a difference in the two sorts of filings is not necessarily to perceive hypocrisy—or at least no more hypocrisy than the adversarial system itself entails. And to demand that the two sorts of filings be essentially the same is to distort the one or the other.

Perhaps the post-Watergate morality has elevated us to the point where we can no longer tolerate the sophism of the adversary system. Moreover, morality aside, perhaps the adversary system really does not work. It has been described, after all, as resting upon the misconception that one obtains a clear picture by making a double-exposed photograph, with the camera focused first too short and then too long. The criticism may well have some validity, but it is hardly eliminated by bringing only one of the two exposures into focus—which would be the effect of what Mr. Nader would impose. Corporations would have to be precise and objective in their rulemaking filings; but noncorporate parties would remain free to stretch a point. That the tendency to do so is characteristic of all advocates, and not merely of corporations, is demonstrated, curiously enough, by the rulemaking filing of one of Mr. Nader's own organizations, concerning the very proposal at issue here. The most horrendous example of "crosstown hypocrisy" set forth in that filing was a company representation to the Supreme Court that a benzene standard proposed by the Occupational Safety and Health Administration "would bring the tire manufacturing industry to a standstill," contrasted with an SEC filing by the same company advising shareholders that the standard would have "no material adverse effect." It turns out, however, that the SEC filing related to a later, revised standard—one that had been relaxed precisely to facilitate industry compliance.

Unless the Nader proposal is changed to include some appropriate remedy for such noncorporate hyperbole, it represents not a radical abandonment of the adversary system but, to the contrary, one of the classic gambits in the book of adversary strategy, to be found under the heading "handicapping one's opponent."

Reforming Trucking Regulation

Deregulation it is not—but significant regulatory reform is coming to interstate trucking this year. "The Motor Carrier Act of 1980" (H.R. 6418) was reported to the House on June 3 after being substantially revised in the Public Works and Transportation Committee to reflect a "delicate compromise" involving the trucking industry, the Teamsters, consumer groups, key senators, and the White House. The bill that emerged from committee resembles, in most substantive respects, the pro-reform bill passed by the Senate on April 15. But it placates the trucking interests by including certain restraints on the pace of reform. Truckers were especially pleased with the bills' postponement of deregulatory steps already planned by the Interstate Commerce Commission and with the bill's admonition that the ICC "should be given explicit direction for regulation of the motor carrier industry and well defined parameters within which it may act

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

pursuant to congressional policy." The trucking interests had fought deregulation for years but, as it gained momentum, they came to prefer the certainty of legislation to the uncertainty of having to deal with an increasingly free-market ICC.

H.R. 6418 deals with the factors on which increased competition and efficiency in the motor-carrier industry depend: easing entry, reducing operating restrictions, allowing some ratemaking freedom, limiting the antitrust immunity accorded to collective ratemaking, and increasing the portion of the traffic that is exempt from ICC regulation.

On entry. Upon enactment, H.R. 6418 will make it easier for common-carrier truckers to obtain new operating authority by effectively shifting the burden of proof from the applicant to those who oppose the application. It does this by providing that the commission, in order to deny a certificate, will have to find the applying carrier's entry "inconsistent with" (rather than "required by") the present or future public convenience and necessity. The applicant will merely have to show that it is "fit, willing and able" to provide the service and that the service will "serve a useful public purpose." The protestant, on the other hand, even to have the right to complain must show that it already has authority to handle all or part of the traffic in question, is willing and able to provide the service the shipper needs, and has performed the service within the last year; or that it had filed an application for substantially the same traffic prior to the applicant. These relaxed entry provisions apply to both contract and common carriers. The bill also allows the commission to award common-carrier operating rights to contract carriers when appropriate.

On operating restrictions. Some observers see the largely unheralded provisions for dismantling many unsupportable restrictions on trucker operations as likely to have the greatest immediate impact on the efficiency of the industry. H.R. 6418 requires the elimination of all gateway restrictions and circuitous route limitations within 180 days of its enactment. The bill also provides that the commission must adopt regulations to broaden the categories of property a carrier may transport, to allow intermediate stops and round trips, and to eliminate "unreasonable or excessively narrow territorial limitations" and any other rule that the commission finds "wasteful of fuel, inefficient or contrary to the public interest."

On ratemaking freedom. Trucking companies will be allowed to set rates without interference within a zone of freedom ranging from 10 percent below the rate in effect one year prior to the enactment of the legislation to 10 percent above that rate. Because the upper limit is keyed to the producers' price index and the lower limit remains fixed, the zone will expand in inflationary periods. In addition, upon making certain findings, the ICC can increase the size of the zone by as many as five percentage points. Rates that are within the zone will not be subject to investigation, suspension, or revocation by the ICC on the grounds that they are unreasonably high or low; but such rates will be subject to the antitrust laws.

On collective ratemaking. The House bill prohibits the written agreements under which private motor-carrier rate bureaus operate from providing for discussion or voting on single-line rates after January 1, 1984. Single-line rates—which are the rates that a single trucker is allowed to charge on a specific route by the rate bureau to which it and other truckers in the region belong—have been a key factor in the truckers' ability to fix prices. The withdrawal of the antitrust immunity from this activity will force truckers to set prices on a more competitive basis. The bill also (1) requires rate bureaus to act on applications for a rate change within 120 days, (2) prohibits interference with each carrier's right of independent action, (3) limits the role of rate bureau staff (as distinguished from member carriers), and (4) requires that "any person" may attend meetings and learn of the votes cast by individual carriers. Finally, reflecting an element of the "delicate compromise," the bill establishes a Motor Carrier Ratemaking Study Commission to study the ratemaking process and the need for antitrust immunity, with a mandate to report to the President and Congress by January 1, 1983. But even if the study commission concludes that the public interest would not be served by withdrawing antitrust immunity from single-line ratemaking, new legislation would be required to prevent that immunity from expiring as scheduled.

On exemptions. H.R. 6418 exempts from regulation two additional commodity groups, animal feeds and nonhazardous agricultural

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

chemicals and fertilizers, as well as private carriage among 100-percent-owned corporate subsidiaries. It does not, however, include the controversial processed foods exemption that was contained in the Senate bill. (That exemption was strongly opposed by shippers in the food and food products industry—who find the rate bureaus' schedules of rates more predictable than an open market and are, in any event, able to pass transportation costs along to the consumer.) In the opinion of some procompetition observers, the absence of this exemption will be substantially offset by the fact that relaxed entry will allow truckers to handle the processed foods traffic almost as if it were exempt.

The compromise bill has been hailed as a milestone in deregulation. That is perhaps the least apt analogy. Milestones are seldom erected by compromise agreements among competing interests who disagree fundamentally about where the road comes from and where it is going. The ultimate effect of H.R. 6418 will depend to a considerable degree on the ICC's continuing disposition toward increased competition for the trucking industry. And the bill, by explicitly confining the ICC to a congressionally prescribed agenda, in fact limits in some respects the scope within which such disposition can be indulged. Nevertheless, it is an historic step: if not deregulation, it is at least important regulatory reform.

Congressional Control

On May 28, President Carter signed into law the Federal Trade Commission Improvements Act of 1980. From the White House point of view, the most significant feature of the twenty-six-page legislation was the nine lines authorizing the appropriation needed for the FTC to continue (or, more accurately, to resume) its functioning. And perhaps the major quid for that quo was the imposition of a two-house legislative veto upon all FTC rulemaking. Although Carter had threatened to veto all congressional veto proposals, he—like earlier presidents—was unable to maintain that resolve in a high-stakes game of legislative chicken.

The President's signing statement expressed the view that the legislative veto feature was "unwise and unconstitutional" and declared, "I look forward to . . . a court challenge." The latter form of expression may seem oddly passive, as though the White House has no control over whether or when to challenge such an impairment of the President's role in the legislative process. But that may in fact be the case. The FTC, being an independent regulatory agency, is part of the "headless fourth branch"; and it will be incumbent upon not the elected President but the appointed FTC commissioners to make the bold decision to disregard the veto process or (even worse) to ignore a congressional veto—one or the other of which politically difficult (and, in the case of the FTC, perhaps suicidal) steps seems necessary if the government is to place the veto in a litigable posture.

The executive branch is proceeding, however, to place the legislative veto at issue in a context that is within its control—and that involves an agency less likely than the FTC to provoke massive congressional retaliation. On June 6, Shirley Hufstedler, secretary of the new Department of Education, announced in a memo to her senior staff that she would act upon the Justice Department's advice and ignore the Congress's veto of four of her department's regulations. Such action is almost certain to provoke challenge to the regulations by affected parties, and in opposing that challenge, the executive branch may get its day in court on the legislative veto question.

Meanwhile, a new solution for the problem of congressional control has been proposed—one that is both clearly constitutional and more effective than the legislative veto. The House Rules Committee's Subcommittee on Rules of the House recently considered the legislative veto device in connection with pending regulatory reform legislation. In March 1980, on the basis of extensive hearings, Chairman John J. Moakley (Democrat, Massachusetts) forwarded to the full committee a report and recommendation, which concluded: "Enactment of a generic legislative veto may be politically expedient but it would solve only a small portion of our regulatory problems while allowing the underlying deterioration of the regulatory system to continue." The report (March 1980) acknowledges that a central part of the problem is that Congress has granted regulatory agencies "broad and far-reaching authority with virtually no guidance" for implementing it. "Congress must," it asserts, "look to itself to

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

provide the institutional mechanism for identifying the balancing conflicts and duplications among national regulatory policies, programs and rules." The report finds the currently proposed versions of generic legislative veto inadequate for this purpose because they rely upon the current committee structure.

> . . . Congress, in its present structure, cannot possibly assess the cumulative impact of the various regulatory policies enacted into law. Committee jurisdiction does not permit such a perspective. . . . The legislative veto, as an added oversight tool used within the existing structure, would be subject to the same institutional weaknesses which now preclude the overall consideration of broad areas of regulatory policy.
>
> The legislative veto, added to the arsenal presently available to the various subcommittees in the House, might also strengthen the "iron triangle" or "subsystem politics" which exist among the legislative subcommittees, regulatory agencies, and the regulated industries. . . . As a result, it is very likely that Congress will compound its present inability to develop a coherent regulatory policy.

Cong. Moakley's proposed solution is a Select Committee on Regulatory Affairs, with jurisdiction over all federal rulemaking activities. The select committee would be required to investigate an agency rule at the request of any standing committee, and it would be permitted to do so on its own initiative or at the request of any member of the House. Following an investigation, the committee's report on a proposed or promulgated rule could be placed before the full House, and the "moral effect" of the report's adoption would be relied upon to induce the agency to make the suggested changes. Beyond that, the select committee could report out a resolution of disapproval which, if adopted by both houses of Congress (and submitted to the President for his approval or veto), would nullify the rule. In addition —and perhaps most important of all—the Speaker of the House would be empowered to refer to the select committee legislation that authorizes rulemaking, for a report on "(1) the adequacy of the guidance provided to the agency . . . and (2) the appropriateness of such delegation of legislative authority. . . ."

The Moakley report, which takes the form of a committee print prepared for consideration by the full Committee on Rules, is unusually frank and insightful. Although the political obstacles to its adoption are considerable, its recommendations deserve careful attention.

Diesel Automobiles: A Mixed Blessing?

The diesel car ranks as one of the best prospects for maintaining accustomed levels of automobile comfort and safety without sacrificing fuel economy. Even drivers who require undiminished performance can expect their diesels to use 25 to 30 percent less fuel than gasoline-powered cars. And apart from what safety may be derived from mere size and weight, the diesel, because its fuel is less volatile, is less likely to burn or explode in an accident—so much so that truck and marine insurance rates are discounted 10 to 15 percent when diesel power is employed.

However, the diesel's environmental impact is mixed. On the one hand, diesels produce far fewer hydrocarbon and carbon monoxide emissions than do gasoline engines. Indeed, this advantage is substantial when the entire production and distribution systems for diesel fuel and gasoline are compared. On the other hand, diesels emit 30 to 70 times more particulates (particles of unburned fuel) than do gasoline engines equipped with catalytic converters and burning unleaded fuel. And questions about the health effects of these particulates have dimmed the diesel's promise as a fuel-saving alternative.

Under the Clean Air Act Amendments of 1977, the Environmental Protection Agency is required to issue standards reducing diesel particulates to the maximum extent permitted by available technology, for vehicles made during and after the 1981 model year. In February 1979, EPA proposed regulations to hold diesel particulate emissions for all car models to 0.6 grams per mile in 1981 and 0.2 grams per mile in 1983. One year later, having concluded that diesel manufacturers needed more time to develop the necessary technology, the agency issued final regulations that postponed the proposed 1981 standard for one year and the 1983 standard for two years.

Even with this delay, however, the EPA has been forced to postpone compliance with the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

nitrous oxide (NO_x) standard of 1.0 gram per mile mandated by the Clean Air Act. All manufacturers of diesel cars have now been granted waivers to emit an average of 1.5 grams per mile until 1983. The waivers are needed because currently available devices for lowering NO_x emissions raise particulates to such an extent that diesels fitted to comply with the 1981 NO_x standards would emit 0.5 grams more particulates per mile.

Both the NO_x and the particulate standards reflect the Clean Air Act's strategy of "technology forcing"—mandating levels of pollution control unachievable by current technology and hoping, like Mr. Micawber, that something will turn up. While this strategy is meant to overcome the lack of concrete incentives to develop pollution control technology, it leads to an obvious problem. If the needed technology does not turn up, Congress or EPA must waive or delay the standards, unless they are willing to accept responsibility for the resulting damage to the industry and the economy. But granting waivers when no honest effort at compliance has been made undermines the incentive to discover the technology in the first place. The central issue thus becomes whether the industry has made a good faith effort to develop the mandated technology; only if it cannot demonstrate such an effort will it be penalized. The inherently uncertain outcome of any inquiry into "good faith efforts" does not enhance the manufacturer's disposition to commit capital to fields subject to "technology forcing" regulation.

Moreover, technology forcing, particularly attempts at achieving quick reduction in effluent levels, may result in high-cost and relatively less effective technological solutions. The Council on Wage and Price Stability, in commenting on the proposed diesel regulations, noted that "the pressure of the original 1975 and 1976 standards for HC, CO, and NO_x, may have locked the American auto industry into its current catalyst technology, which [may be] less desirable than alternative technologies which might have been developed."

Economists, of course, would prefer economic incentives to the technology-forcing approach. In the case of pollution control, effluent fees set at an appropriate incentive level could be expected to lead to the desired reduction in emissions at less overall cost than technology-based standards. Whether EPA has the option of trying an effluent fee approach is doubtful. There is express statutory authority to use such an approach for stationary sources of pollution and large trucks, and perhaps for light trucks, but not for diesel passenger cars. The agency does, however, have the option of permitting corporate fleet averaging—requiring that a manufacturer's fleet rather than each model in that fleet adhere to the particulate standard. An averaging approach would work much like EPA's recently announced "bubble" scheme for regulating stationary source pollution. (See article by M. T. Maloney and Bruce Yandle, page 49, this issue.) It would allow an automaker to increase emissions where marginal costs of control are high if it could achieve corresponding sales-weighted reductions where costs were low.

Several automakers have proposed averaging plans, but they disagree on how the average should be calculated. General Motors's plan specifies a particulate standard much tougher than EPA's, but would apply it to an automaker's entire fleet, including gasoline-powered cars—which by now emit virtually no particulates. This scheme would impose an enormous hardship on Volkswagen and Mercedes, whose diesels are cleaner than GM's but represent a much larger percentage of their overall sales. Thus Volkswagen's counterproposal would keep the EPA standard but compute the average over only the automaker's diesel fleet. CWPS also favors a diesels-only average—on cost-effectiveness grounds.

EPA has rejected both averaging plans. It does not deny that averaging would lower the costs of meeting the particulate standard; but it notes that automakers have not offered figures detailing the expected savings, and it expresses concern over the differential impact of the plans among automakers and the administrative burden of monitoring the sales of each model. (As to the latter point, it may be observed that federal fuel-economy standards now operate on just such a sales-weighted system.) EPA has, however, set up a task force to study averaging, with an eye to developing a scheme for upcoming regulations on heavy-duty truck NO_x emissions, and says it will use that study to determine the feasibility of averaging for other mobile source pollutants.

(*Continues on page 52*)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Viewpoint

Paul Johnson

The Perils of Risk Avoidance

THE CENTRAL WEAKNESS of the present-day British economy is the huge range of legal immunities enjoyed by trade unions. The central weakness of the U.S. economy is the vast and growing power of the regulatory agency and the recklessness with which that power is being employed in the pursuit of a risk-free society. At first glance these two weaknesses seem very different, but in economic terms they have the same consequences: Both raise the unit cost of production. Both reduce or eliminate growth in productivity. Both discourage or penalize innovation and make investment unrewarding. And, not least important, both consume increasing amounts of time and energy, diverting management from its real business. In short, both are Old Men of the Sea, clinging with vise-like grip around the neck of Sinbad the Capitalist. And these are not static relationships. In both cases the Old Man is getting heavier and Sinbad weaker.

These weaknesses are difficult to attack, because they spring from social impulses that are themselves beneficent and necessary. No one wants to destroy trade unions. No one denies that government must play a certain role in regulating industry. It is all a matter of balance, and the art of politics is knowing when and how to adjust the balance. In Britain, there is now a consensus that the legal privileges of the unions are too great, and the Thatcher government is attempting to reduce them. In the United States, I suggest, there is growing evidence that the regulation of industry, especially in the health, safety, and environment fields, is excessive and dangerous (while often ineffective) and that the need to redress the balance is urgent.

Paul Johnson, a British journalist and historian, holds the DeWitt Wallace chair of communications at the American Enterprise Institute.

First, let me make it clear that I am a strong supporter of government safety and anti-pollution programs. I yield to none in my admiration of Rachel Carson, whose splendid articles in the *New Yorker* first drew public attention to the way in which we were poisoning our planet. Anti-pollution measures can be cheap and astonishingly successful over a period. In Britain, at comparatively small cost and without inflicting any damage on the economy, we have virtually eliminated the Dickens-style London pea-soup fog; and the Thames is now cleaner than it was in the time of Shakespeare. But it is a fact of life that in the field of safety and pollution, the law of diminishing returns operates with peculiar ferocity. It is an area where absolute standards are often impossible and where the attempt to achieve them quickly becomes intolerably expensive.

Dangers of Absolutism

Unfortunately, absolutism has become the hallmark of the U.S. approach toward pollution and risk control. Nor is this surprising. One of the keys to understanding the twentieth century is to identify the beneficiaries of the decline in formal religion. The religious impulse—with all the excesses of zealotry and intolerance it can produce—remains powerful, but expresses itself in secular substitutes. None is more attractive, especially in the advanced Western countries and above all in the United States, than the creed of Safety First. Uniting as it does a wide range of health and consumer pressure groups, animated as it is by a quasi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

mystical vision of total purity, it provides an unrivaled emotional outlet for educated, middle-class opinion. It has become the leading progressive good cause of our day, combining fear of technology, hatred of capitalism (especially the giant corporation), the itch to interfere, and the eternal nanny-principle. Inevitably, it has focused most sharply on two subjects where the maximum of public apprehension coincides with the minimum of public understanding—nuclear power and carcinogens. Nuclear power is the new Sin against the Holy Ghost—radiating evil, as it were, over the whole planet and, like Original Sin, even infecting future generations. The carcinogen is the universal, ubiquitous, omnipresent spirit of Satan, threatening to poison all with its corruption. There can be no compromise with these sins: they must be rooted out, once and forever.

The safety-first lobby has succeeded in converting a large segment of congressional and governmental opinion to its absolutist approach. The outstanding example is the Federal Water Pollution Control Amendments of 1972 which, in a *fiat* unmatched since Genesis,

Nuclear power is the new Sin against the Holy Ghost—radiating evil . . . over the whole planet and, like Original Sin, even infecting future generations. The carcinogen is the universal, ubiquitous, omnipresent spirit of Satan, threatening to poison all. . . .

ordered that there be "zero discharge" of pollutants into streams and lakes by 1985. This strikingly illustrates the law of diminishing returns. As Martin J. Bailey points out (*Reducing Risks to Life*), the cost of meeting just the "interim standards" laid down for 1983 has been estimated at $468 billion, along with operating costs of some $150 billion a year. And the capital costs of even approaching the full statutory goal would be in excess of the nation's entire gross national product. Absolutism in the carcinogen field leads to the same astronomical outlays. The Occupational Safety and Health Administration (OSHA), which so far has proposed regulations on only a few carcinogens, recently speculated that it would issue new standards on 571 of the 2,400 suspect carcinogens it has identified. According to James C. Miller III, the total annual cost of the seven OSHA carcinogen regulations for which estimates are available is $96 million each. Covering an additional 571 suspected carcinogens at a similar annual cost would consume $55 billion a year.

Hence, if we total up the cost of absolutist schemes for just two areas of risk control, water pollution and carcinogens in the workplace, we come up with a price tag of $205 billion a year. To pay for this huge increase in expenditure, equivalent to roughly 10 percent of a gross national product of $2 trillion, American living standards would have to be reduced significantly. Yet the increase in life expectancy over the past 150 years reflects, and in general is explained by, the increase in living standards. If living standards are substantially reduced over a period, life expectancy must decline. Thus the quest for absolute safety from pollution and carcinogens is self-defeating.

The Custer Syndrome

This simple calculation points to the irrational basis on which much regulatory legislation is enacted and enforced. The danger is that the Gadarene swine, in fleeing the devils, will hurl themselves over the cliff. There are two particular forms of irrationality we should guard against. The first is what I call the General Custer Syndrome: take action at any cost, do it as quickly as possible, and leave the thinking till afterwards. Most anti-risk measures passed by Congress in the 1970s fall into this category, since they make no allowance for the cost of enforcement and arouse correspondingly unrealistic expectations among those who expect to benefit from them. The syndrome is summed up in a statement by a representative of the oil and chemical workers union, Anthony Mazzocchi: "Congress mandated very specifically that the workplace should be free of hazards. It didn't say the workplace should be free from hazards only if the employer could afford it, or only if it wouldn't cost him too much money" (*Washington Post*, May 12, 1977). But of course the only workplace totally free of hazards is one without workers—and if compliance with

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

absolutist regulations leads to bankruptcy, that will indeed be the end result. Unemployed workers are, in terms of the congressional enactment, 100 percent hazard-free.

The General Custer Syndrome takes its most common form in the disparaging of cost-benefit analysis. A leading safety-firster, Mark Green of Congress Watch, argues that "given the state of the economic art, mathematical cost-benefit analyses are about as neutral as voter literacy tests in the old South" (*Washington Post*, January 21, 1979). This hostility is shared by some politicians prominent in safety legislation. Thus a 1976 report of the Subcommittee on Oversight and Investigation of the House Committee on Interstate and Foreign Commerce argued that, in risk control, cost-benefit analysis creates "a bias against the public interest" and causes delay in the implementation of regulatory policies. But surely such analysis cannot be against the public interest if it shows that the taxpayer is getting poor value for his money; and if it delays badly formulated and ill-considered regulations, so much the better.

The value of cost-benefit analysis—as well as of its cousin, cost-effectiveness analysis—is that it injects rational calculation into a highly emotional subject. Properly conducted, it can give you the net cost or net benefit of what you are proposing to do, and tell you approximately how many lives (if any) it will save. Equally important, it offers you a range of alternatives. Without stringent analysis, nobody knows whether the costs imposed by regulatory programs are money well spent. Calculations of the cost per-life-saved by such activities vary enormously. Estimates included in a recent compilation by Bailey ranged from $37,500 per life saved for the low-cost program of traffic safety and $240,000–$1.9 million for lawn-mower safety standards (as proposed) on up to $4.5 million–158 million for the coke-oven emission standards and $2 million–625 million for limiting occupational exposure to acrylonitrile. Given these ranges of magnitude, the opportunities for devising more efficient approaches—and thus of saving more lives—are enormous. Bailey takes the hypothetical example of a $20 billion expenditure on health and safety programs and shows that, by cutting down inefficient programs and reinforcing successful ones, as many as 190,000 additional lives could be saved for the same total cost. Given that resources are limited and that safety programs are rapidly hitting budgetary ceilings, rigorous analysis of costs and benefits is essential. Yet it is ignored by most existing legislation and by the practice of the enforcement agencies.

... the only workplace totally free of hazards is one without workers—and if compliance with absolutist regulations leads to bankruptcy, that will indeed be the end result. Unemployed workers are, in terms of the congressional enactment, 100 percent hazard-free.

The Howard Hughes Syndrome

I call the second form of irrationality the Howard Hughes Syndrome. The late Mr. Hughes had some scientific knowledge and used it—or misused it—in an attempt to insulate himself completely from all contagious infection. As a result, he spent the last years of his life almost completely isolated, much of the time stark naked. All this took place at enormous cost, and Mr. Hughes ended up dead just like anybody else—indeed, it is even possible that he died of self-inflicted malnutrition.

The approach of Congress, and still more of the regulatory agencies, to the problem of risk often exhibits the Howard Hughes Syndrome. Carcinogen regulation is a case in point. Statutes for controlling carcinogen exposure are typically animated by the ideal of absolute safety at any cost. And agency enforcement, though theoretically based on the results of scientific experiments, generally reflects an emotional and selective use of science—the purpose being to impose upon laboratory research a degree of certitude and a tempo of certification wholly alien to scientific method. OSHA, in its generic carcinogen policy issued on January 22, 1980, has streamlined its process for regulating carcinogens by the simple device of arbitrarily excluding from future rulemakings debate on many of the basic scientific issues involved.

In an important article in *Science* (April 18, 1980), Dr. Gio Batta Gori, then deputy direc-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tor of the Division of Cancer Cause and Prevention, National Cancer Institute, shows that the exigencies of regulatory agencies have often forced scientists "to produce clear-cut statements that, however convenient for the regulator, may not have scientific justification." As a result, tests have been loaded to produce a positive finding of carcinogenicity. He writes: "Current guidelines for the testing of carcinogens frequently introduce deliberate bias in order to enhance the probability of a positive response" and "ignore a number of sources of variability that cannot be controlled or are difficult to control with available technology." A laboratory scientist—asked to swear, his hand on his heart, that a substance is absolutely harmless—is bound to answer no; and if he devises a series of tests to determine whether there is risk, however minimal, he is virtually certain to find it. Does that mean the substance should be banned? The regulator says yes. The scientist says not necessarily—for we may be protected by no-effect thresholds. As Dr. Gori points out, "the probable occurrence of thresholds has usually been ignored, and some regulatory guidelines specifically prevent considering them." The regulator, in his absolutist enthusiasm, is thus jostling the scientist into a nonscientific posture. Dr. Gori asks for official recognition "that risk is an unavoidable element of life and the common welfare, that all human lives cannot be preserved at all costs, and that carcinogenicity tests in animals cannot be reliable quantitative models of human risks."

By ignoring the true principles on which scientific research is conducted, which always involve a careful balance of probabilities, the regulators may be saddling us all with hideously expensive and fundamentally unnecessary policies. Worse: they may be costing lives instead of saving them.

By ignoring the true principles on which scientific research is conducted, which always involve a careful balance of probabilities, the regulators may be saddling us all with hideously expensive and fundamentally unnecessary policies. Worse: they may be costing lives instead of saving them. The approach of the Food and Drug Administration (FDA) to the marketing of new drugs looks like a case of the Howard Hughes Syndrome. As a result of the 1962 drug amendments and implementing regulations, the number of new chemical entities reaching the U.S. market has been reduced by more than half. It is probably true that the efficacy requirements imposed by the 1962 law have prevented the marketing of some questionably effective drugs; it is at least as likely that doctors have been forced to prescribe relatively ineffective drugs that would have been replaced by new and more effective drugs but for the 1962 law. William Wardell of the University of Rochester Medical Center reports that the unavailability of the beta-blocker alprenolol in the U.S. market, a result of regulatory stringencies, is costing Americans 10,000 coronary deaths a year (*Regulation*, September/October 1979). Here again, the absolutism of the regulator, to whom all things are strident black or white, sinful or virtuous, is in conflict with the scientific approach of balancing probabilities and calculating the varieties of risk.

Zeal versus Reason

It is perhaps natural that America, whose public life has always sought to express absolute moral ideals, should bring to the regulation of risk a quasi-religious zeal and intransigence. This has considerable value in the first phase of a reforming program, the value of impressing on all concerned the importance and urgency of the issue. But there comes a time when rational computation must replace primitive zealotry. In risk control, the best is the enemy of the good. Given that resources are limited, control must be selective. As my old political mentor Pierre Mendès-France used to say, *Gouverner, c'est choisir*. The wisdom of government usually lies not in insisting on the ideal but in choosing the lesser evil. As citizens we have different evaluations of the hazards that threaten us, and government ought to be an act of arbitration between these conflicting claims. It is significant that those who are most vociferous in recommending to us an absolutist control of carcinogens and nuclear risk are silent on the matter of fallout shelters and posi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tively hostile toward the provision of an adequate military deterrent, another form of risk control. In risk evaluation, one man's prudence is another man's paranoia.

The truth is that the human race maintains and improves its position by a sensible calculation of risks. There is no such thing as a no-risk society. The very act of seeking to eliminate risk often produces new and unsuspected hazards, which may be far greater than those sought to be avoided. America's obsession with health and safety problems—and the translation of that obsession into absolutist legislation and inflexible enforcement—could create risks of an altogether greater magnitude if it places unacceptable burdens on the U.S. productive system. It is already arguable that government regulation is the main factor in the virtually nil growth of productivity which is by far the most worrisome feature of the U.S. economy. The risk posed by a collapse of Sinbad the Capitalist is infinitely more serious than any conceivable volume of pollution.

Safety Lies in Risk

Indeed, we must get into our heads that the maintenance of a growth economy is far and away the best general insurance against risks of all kinds. After all, the rise in real incomes that made possible the extension of life expectancy during the nineteenth and twentieth centuries was the direct result of the creation of industrial capitalism, a productive system based, and essentially based, on risk-taking. You could say that the Industrial Revolution itself was one gigantic risk. It took place on very narrow profit margins which would have been eliminated by even a fraction of the health and safety regulations now imposed by law. If we had had Naderism in the eighteenth century, the Industrial Revolution could not possibly have happened. A demographic catastrophe would then have followed, and we would still be living—if we were lucky—at eighteenth century rates of real wages and enjoying eighteenth century standards of health care and, not least, eighteenth century levels of pollution. (If you want to see what those were like, visit the slums of Calcutta or Djakarta.)

Although it is common to describe man as a tool-making animal, I think a broader and more satisfactory description would be a risk-taking animal. Accepting risks is part of his propensity to calculate and his willingness to gamble on long-term results. He has constantly enlarged the horizons of his experience—and so ensured the survival and growth of his species—by taking risks with nature. It makes me smile that some of the most ardent members of the safety-first brigade call themselves Friends of the Earth, as though the earth were an innocent and defenseless living personality, to be protected from rape and despoilation by humans. I imagine such people lead sheltered, stay-at-home lives, for anyone who has traveled the globe and seen nature in all its implacable, though inanimate, hostility, comes to see man's slow but sure conquest of his environment as the most enduring triumph of the human spirit.

Although it is common to describe man as a tool-making animal, I think a broader and more satisfactory description would be a risk-taking animal.

I am reminded of some of the earliest hieroglyphic inscriptions of ancient Egypt, which tell us that the stones on which they were carved, being very rare and beautiful, were obtained by long and arduous journeys across the pitiless desert, in which many died. The Egyptians were not reckless: they did their best to reduce losses by establishing water deposits on the route or by digging wells, often to an extraordinary depth. But the casualties they nonetheless suffered did not deter them from the pursuit of the beauty that for them made life worth living.

The whole of our civilization in its spiritual as well as its material aspects rests upon an endless accumulation of risks courageously taken by successive generations. We enjoy today—in our high standard of living, in our unthinking acceptance of mechanical marvels—the advantages paid for by the risks taken by our forebears. We repay our debt to the species by taking risks on behalf of our progeny. Calculating risks is common sense. But seeking to eliminate them altogether is impossible—and the attempt to do so is ignoble. Ironically, it is also very dangerous. Not to take risks is the biggest risk of all. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Case for Corporate Democracy

Mark Green

WHEREAS THE American political agenda of the 1970s focused extensively on the size and abuses of *big government*, the agenda of the 1980s should focus on the size and abuses of *big business*. It is curious how partisans of the latter can ridicule the inefficiencies and unresponsiveness of federal bureaucracies yet somehow ignore similar problems with corporate bureaucracies. Who governs our giant corporations and how they in turn govern us—economically, politically, biologically—should be preeminent issues in a society whose democratic values require that major institutions be accountable to their various constituencies.

To be sure, there are laissez faire "theologians" who argue that the "free market" is a perfectly self-regulating mechanism, that corporations are merely pass-through devices that respond automatically to the "votes" of autonomous consumers in the marketplace. In fact, corporations are entities run by real people who make two kinds of judgments. First, they decide whether or not to obey the law—which apparently is a difficult choice for many of them. Second, because the law is society's statement of what constitutes *minimally* acceptable behavior, they make choices within a huge area of lawful discretion—where to locate a plant, whether to fight or cooperate with a unionizing effort, what to produce and how to price it, what legislation to support or oppose, whether to participate in the community or to pollute it. The key issue of corporate governance reform is *who* should make or shape these decisions—a handful of executives, or executives *and* a representative board that is open and responsive to the views of a company's many stakeholders?

Mark Green, former director of Public Citizen's Congress Watch, was president of the board of directors of "Big Business Day—1980."

This fundamental issue of unaccountable corporate power warrants federal legislation for several interrelated reasons:

- *State chartering has failed.* It makes as much sense for states to print money or passports as to issue the legal birth certificates of corporations that market products interstate, if not internationally. The result of this historical anomaly, in the words of Harry First, is a kind of "law for sale" (*Pennsylvania Law Review*, 1969). States lure companies into their jurisdictions, and thus generate incorporation fees, by adopting corporation codes that are excessively pro-management. Because Delaware is the worst state in this regard, it gets the most business: about one-fifth of all Delaware state revenues comes from incorporation and annual fees; and about half of the Fortune 500 are incorporated in tiny Delaware, including Exxon Corporation, for example, which has 160 times the annual revenue of its legal parent. Because other states try generally to imitate Delaware's performance rather than act more responsibly, there is already a kind of federal chartering law—but one drafted in Wilmington, not Washington.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

• *Corporate illegality is extensive.* As examples of antitrust violations, chemical dumping, product hazard cover-ups, consumer fraud, foreign payoffs, and other economic crimes proliferate, it becomes increasingly apparent that management-directed illegality is prevalent rather than aberrational. "The people who call the shots don't bear the risks," concludes law professor Christopher Stone in his book *Where the Law Ends.* The unblinkable documentation of illegal practices should inspire lawmakers to design a new system of internal governance backed up by workable sanctions in order to encourage lawful behavior. When, for example, there was extensive congressional and press attention on labor racketeering in the late 1950s, the result was a Landrum Griffin Act for labor unions. Today we need a kind of Landrum Griffin Act for our largest corporations—to deal with the problem of corporate "racketeering" in the 1980s.

• *Our largest corporations are private governments.* Edmund Burke's observation that the large companies of his time were states disguised as merchants is relevant today. One definition of government would be an entity that can tax, take life, and coerce citizens. But what is price-fixing but corporate taxation? What is the willful marketing of defective products but the needless taking of life? What is industrial air pollution or the poisoning of a waterway but coercing citizens to suffer the results of other peoples' transactions—that is, compulsory consumption? In other words, our largest firms exercise extraordinary influence over the citizens of our country and other countries.

Thus, the traditional distinction between the public and private sectors should give way to a new concept about the role of the large corporation—namely—there are two forms of government in the United States, the political government and the economic government. The political government is held roughly accountable to its citizens by means of the Constitution and elections. But the economic government is largely unaccountable to its multiplicity of constituencies—shareholders, workers, consumers, local communities, taxpayers, small businesses, future generations. Ironically, under the Fourteenth Amendment, corporations are accorded the rights of people but not the obligations of governments—although our giant companies are far more like huge governments than they are like real people.

The Content of the Corporate Democracy Act

Representative Benjamin Rosenthal (Democrat, New York) and seventeen colleagues introduced H.R. 7010, the Corporate Democracy Act, in April. Its provisions would establish

© 1980, Regulation Magazine

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

minimum governance standards for the 800 largest U.S. nonfinancial corporations (those with $250 million or more in assets). The goal is not more regulation but more *self-regulation* so that these "private governments" give greater access and voice to their affected stakeholders.

Title I: Directors and Shareholders. By requiring such things as a majority of "independent" directors, cumulative voting, shareholder nominations, and specific committees to oversee law compliance and to receive complaints from interested constituencies, this title seeks to restore the influence and independence of the board of directors.

Almost all students of board activities—from William Douglas in the 1930s to Myles Mace in the 1970s—conclude that directors do not select the top officers, do not establish company objectives, strategies, or policies, do not possess the information necessary even to make such judgments, and rarely if ever dissent from managerial initiatives. Consider, for example, the Penn-Central board before that firm's derailment. "The board was definitely responsible for the trouble," recounted outside director E. Clayton Gengras. Its members "took their fees and . . . just sat there. That poor man from the University of Pennsylvania [University President Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out." Although Penn-Central was desperate for capital, for example, the directors paid out nearly $100 million in dividends just before the company filed for bankruptcy.

Shareholders, too, are relatively powerless. Because management controls the proxy machinery, because shareholders cannot nominate candidates for the board, because individual shareholders are overwhelmed by the bloc votes of institutional investors, the corporate structure typically permits only a ceremonial role for shareholders. The great theory of shareholder democracy, or "people's capitalism," comes down to a few shrill voices at a spring rite called an "annual meeting" which is often held in a distant, difficult-to-travel-to city. Ultimately, disgruntled shareholders sell their shares rather than attempt to throw out inept management. Corporate executives cannot have it both ways—they cannot point to shareholders as the legitimizing constituency of the corporation and also acknowledge privately, as many have in business sessions I have attended, that shareholders are merely interested in dividends, not governance.

The great theory of shareholder democracy, or "people's capitalism," comes down to a few shrill voices at a spring rite called an "annual meeting". . . .

Corporate directors are almost invariably chosen by written proxies, with management so totally dominating the process that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot"—a ballot that lists only one slate of candidates. As is noted in the 1979 staff summary of the Security and Exchange Commission's corporate governance hearings, "According to Professor Seligman [of Northeastern Law School] shareholder democracy has collapsed. . . . Since 1967, incumbent managements have been re-elected 99.9 percent of the time. In the last five years, not one management slate in any of the 500 largest industrial firms was even challenged."

The institutional irrelevance of directors and shareholders is not ordained by economic imperatives. Managers can be required to share power more equitably and efficiently with directors and shareholders. Even a few conscientious, non-management-controlled directors or shareholders, asking the right questions and given adequate authority, can make it less likely that a Penn-Central, a Kepone, a Youngstown (Ohio), or a Chrysler situation will recur.

Title II: Corporate Disclosure. This part of the bill requires that affected companies disclose in simple fashion such information as worker injury data, employee hiring data by facility, profits abroad, and the effective federal tax rate.

John O'Leary, the former deputy secretary of energy, explained to a congressional committee in mid-1979 why the Department of Energy made an agreement with oil firms to keep certain information on supplies secret. "The companies simply don't like the public peering over their shoulders," he said. This

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

sentiment accurately reflects the traditional corporate view toward data disclosure—the less of it the better. But any effective strategy for bringing about greater corporate accountability to affected constituencies must be grounded in greater corporate dissemination of economic and social information. Such information enables shareholders and workers to know what demands to make, helps communities deal more knowledgeably with their business citizens, and informs press and public opinion—which are thereby better equipped to influence corporate policy. Enlightened executives have become well aware that unless they open their books more widely, the threat of increased and more sweeping regulation will grow. Besides, it seems a matter of simple justice, for example, that workers be allowed to know what detectable carcinogens are present in their work places and that community residents be informed of the distribution by race and sex of the work force in local establishments.

That some companies have disclosed full and precise data in these areas demonstrates that the information is neither confidential nor prohibitively costly to gather and report. That significant numbers of firms still refuse to disclose such information indicates that it will not be made consistently available unless required. The information requirements of the proposed act undermine neither customer privacy nor a firm's ability to protect proprietary secrets. Moreover, they are so simple that the information in question can be reduced to a few pages in company annual reports—as companies that already have adopted these standards have demonstrated. The result is a *corporate self-audit*, understandable to shareholders and lay people generally.

Title III: Community Impact Analysis. In an effort to help communities prepare for a plant closing or relocation by a major local employer, this title imposes prenotification requirements and allows the U.S. secretary of labor to conduct a local inquiry into why the change occurred and how best its local costs might be offset.

Bureau of Labor Statistics figures indicate that, overall, the New England, Mid-Atlantic, and Great Lakes regions lost 1.4 million manufacturing jobs between the mid-1960s and mid-1970s. Major cutbacks—both plant closings and partial transfers of work to other areas—have occurred in steel, clothing, textiles, rubber, auto parts, and electronics.

These basic corporate shifts take place for a variety of reasons—the search for nonunion regions, declining industries, outdated facilities, automation, access to new markets, energy costs, and availability of transportation. No sound economy can be wholly static, of course, and few would argue that the answer to economic dislocation lies in mechanisms that seek only to preserve the status quo. But a plant closing or relocation can be devastating to a community, in part because its effects ripple far beyond the employees directly involved. In the Youngstown case, for example, the *additional* loss from the steel shutdown, beyond the 5,000 jobs lost in steel itself, has been estimated at 11,200 jobs—including 1,413 in wholesaling and retailing, 372 in office supplies, and even 35 in auto repair.

These effects are exacerbated when the closings involve dominant local employers and occur unexpectedly. Without warning, the community's tax base shrinks, leaving schools and municipal services underfinanced and leading to layoffs of municipal employees, while demands on public services increase; unemployment skyrockets before anyone can plan to bring in new industry and jobs; and small businesses that had depended on the closed establishment as a customer are left without a market.

Critics of a "community impact analysis" say that it is up to private enterprise to decide where and when to locate or relocate, not government. This may be true, but it is not the issue. The proposal is not to require government approval for a move but rather to insist that employers give advance notice to the affected communities and employees in order to minimize the financial and emotional costs to those least able to bear them. Because some moves can lay waste a town's life-support system, it is entirely appropriate—regardless of whether the corporate decision makers consider themselves members of a purely private entity—that such private decisions be exposed to greater public scrutiny. As even the *Wall Street Journal* has acknowledged, "a company may have a responsibility not to leave its employees or its hometown in the lurch."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Title IV: "Constitutional" Rights of Employees. This title would protect employees from retaliation for the exercise of their constitutional rights of speech and assembly.

An airline pilot with over twenty-five years experience lost his job for blowing the whistle on a serious defect in the Lockheed 1011 aircraft. A worker in upstate New York who participated in a political demonstration was fired by his employer, who held the opposite view on the issue. What did these two workers have in common? Both were nonunion employees in the private sector who, under present law, had no meaningful legal recourse against dismissal.

This problem is neither conjectural nor infrequent. Cornelius Peck has projected from statistics on adjudged "unjust dismissals" in the unionized sector that thousands of such discharges occur annually in the nonunion sector, with no opportunity at all for redress (*Ohio State Law Journal*, 1979).

About one-third of the U.S. work force is protected against unjust dismissal or discipline for political beliefs or activities, either under collective bargaining agreements negotiated by unions or, in the case of government workers, under civil service laws and regulations. But better than two-thirds of the work force is not protected. These nonunion, nongovernment workers are subject to the archaic common-law rule of "servant at will." And under this rule, the employer is no more bound to the employee than the employee to the employer: either can break out of the employment relationship for "any or no reason." In short, the majority of American workers have the right to be fired—in the term of art used in court—"for good cause, for no cause, or even for morally wrong cause," without being the victim of a legal wrong.

The United States is one of the few industrialized nations that does not provide legal protection against unjust dismissals. France, West Germany, and Great Britain, for example, have developed not only extensive bodies of law to protect the worker's right to his or her job but also procedures to ensure that protection is provided as promptly, inexpensively, and fairly as possible. The Corporate Democracy Act would mandate that employees not be disciplined or discharged for exercising their political or other constitutional or civil rights, or for "corporate whistle-blowing." And it would protect employees against discrimination, discipline, or discharge for refusal to grant sexual "favors" to managerial employees.

Title V: Criminal and Civil Sanctions. This title provides for various penalties and sanctions designed to deter the existing level of corporate crime and to compensate its victims.

Business crime is as old as business. There were prohibitions against monopoly in common-law England. Lord Bryce's *The American Commonwealth* (1888) and Henry Demarest Lloyd's *Wealth against Commonwealth* (1899) examined that era's business corruption, with Lloyd noting that the Standard Oil Corporation "has done everything with the Pennsylvania legislature except to refine it." Widespread stock fraud led to the 1933 and 1934 securities acts. The 1960s saw the great electrical machinery bid-rigging case and the Richardson Merrell Company's marketing of MER 29 even though the firm had evidence of health risks. And today the apparent prevalence of "corporate crime"—a subcategory of "white collar crime" involving managerial direction of, or participation or acquiescence in, illegal business acts—has raised the issue of the adequacy of legal sanctions. Why has the law failed to deter "crime in the suites?" What new sanctions or governance structures can persuade companies to obey the law? The *New York Times*, in an editorial bristling with indignation, has concluded: "The only effective remedy is to change the incentives and penalties that now shape [illegal] decisions. . . . Otherwise irresponsible decisions will continue to poison not only the physical environment but public confidence as well" (May 1, 1979).

Setting Standards for Corporate Citizenship

The provisions of the proposed Corporate Democracy Act are both reformist *and* realistic, for with few exceptions they have been adopted already by some company or state or Western country. The act would apply only to the largest 800 or so nonfinancial corporations—only to those "private governments" that have little in common with small and medium-sized businesses. It is based on the procedural mechanism of *federal minimum standards*, so that

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

whatever the act does not require is left to existing state incorporation statutes and authorities. A standards rather than a regulatory approach has obvious and prestigious precedent: for example, the 1933 and 1934 securities acts, Title VII of the 1964 Civil Rights Act, the Food and Drug Administration rule that all drug companies establish quality control units. "We have largely federalized the law of antitrust, equal employment and securities," comments Professor Harvey Goldschmidt, of Columbia University's Law School; "the federalization of corporate law is long overdue."

... the issue is not big government versus freedom. The "freedom" to pollute or to market hazardous products or to retaliate against whistle-blowing workers is not quite the freedom our founding fathers had in mind....

Ultimately, then, the issue is not big government versus freedom. The "freedom" to pollute or to market hazardous products or to retaliate against whistle-blowing workers is not quite the freedom our founding fathers had in mind—not, at least, if your perspective is that of the families around Love Canal who were not free *not* to ingest Hooker Chemical Company's toxic residues. Nor is it overregulation versus productivity. Chrysler and U.S. Steel are in trouble because of their own mismanagement, regardless of how much they may "scapegoat" regulation from Washington.

Nor, finally, is the issue capitalism versus socialism. Rather, it is autocracy versus democracy. For decades the abuses within the American economy have been addressed by remedial regulation affecting the *external* relationships of the corporation: don't pollute, don't fix prices, don't deceptively advertise. The Corporate Democracy Act of 1980 aspires to reform the *internal* governance structure of our largest corporations so that—consistent with a market economy—companies would exercise their power and discretion more democratically and accountably. It is a response to the demonstrated limitations of state corporation laws, of regulatory laws, and of criminal laws to deter corporate abuse.

If preliminary comment is any barometer, however, this approach will be the target of rhetorical overkill by the big business community. An overwrought *Business Week* characterized federal corporate chartering as a reminder of "Mussolini's Corporate State." Business partisans organized a "Growth Day," held on the same April 17 that "Big Business Day" undertook a variety of activities to spotlight the effects of corporate power and to promote the Corporate Democracy Act. "Growth Day" advocates said their target was "zero-growth zanies." Richard Whalen attacked "self-appointed vigilantes" who oppose corporate crime, as if it were somehow illegitimate to try to detect and deter the kind of illegal conduct that has been so massively documented. John Riehm of the U.S. Chamber of Commerce charged, apparently without reading the proposed legislation, that "the advocates of corporate chartering would turn over the control of our economy almost completely to Washington." A Chamber of Commerce "Special Report," calling the bill the "Corporate Destruction Act," warned that it "would end the private enterprise system as we know it in America today." Herbert Schmerz, the leading Mobil Co. publicist, said the bill was a "thinly veiled beginning of the socializing of American industry."

Such obvious distortions demean the importance of the issue of corporate governance. One would have thought that genuine conservatives concerned with human liberty, the entrepreneurial spirit, vigorous economic competition, and lawful conduct would care deeply about those big businesses that deny freedoms to others, that acquire rather than innovate, that seek to frustrate competition, and that violate the law. And one would have thought that the big business community would have learned to restrain its impulse for "Chicken Little" rebuttals—an impulse that has led it to oppose nearly every social advance of this century, from child labor laws to auto safety regulation. Instead of dogma, business critics might want to consider a dialogue. "It is not creative minds that produce revolutions," wrote H. G. Wells in *The Salvaging of Civilization*, "but the obstinate conservation of established authority. It is the blank refusal to accept the idea of an orderly evolution toward new things that gives a revolutionary quality to every constructive proposal." ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ON THE CORPORATE DEMOCRACY ACT

What's Not in a Name

Ralph K. Winter

I ONCE HAD occasion to note that proponents of a new government agency to "represent" consumers had blundered in changing the name of the proposed tribunal from the "Consumer Protection Agency" to the "Agency for Consumer Advocacy." Not only was the latter title less catchy, but it was also more (although not completely) accurate. Any degree of accuracy, of course, was fatal to the proposal because it called attention to its merits.

The creators of the "Corporate Democracy Act" have not made the same mistake. The title they have chosen has nothing whatsoever to do with the merits of their proposal.

Briefly stated, H.R. 7010 would (1) mandate federal eligibility requirements for members of corporate boards, impose liability for certain acts upon those directors, and expand the mandatory prerogatives of shareholders; (2) require corporations to comply with stipulated disclosure requirements; (3) impose heavy penalties on corporations that desire to move corporate operations from one locale to another; (4) give tenure to all employees of corporations; and (5) create a variety of penalties to be imposed on corporations and their executives for violating federal and state law.

Obviously, the catalyst that binds together this amalgam of diverse regulatory measures is not democracy, but a generalized anticorporate animus. And the title, "Corporate Democracy Act," is intended not to describe the bill but to shut off debate.

Ralph K. Winter is William K. Townsend professor of law, Yale Law School, and adjunct scholar of the American Enterprise Institute.

Accepting the bill's title at face value, however, a fundamental question may be asked. Why should business corporations, which claim only to be profit-making enterprises for private investors, be subjected to regulation in the name of democracy,* while organizations that boldly proclaim themselves to be "consumer advocates" or "public interest" groups would not be? It makes little sense to argue that Athlone Industries of Parsittany, New Jersey, must be "democratic," while the Nader conglomerate should be run autocratically and in secret. It can hardly be said that the source of funds for the Nader groups over the past decade is of no interest. This is not, I hasten to add, to argue that "public interest" groups ought to be subject to such regulation. They ought not—but because it is bad law rather than because the alleged principle of democratization does not apply.

While there is no space here to conduct a detailed technical analysis of the Corporate Democracy Act, its text is so technically deficient that at least that fact must be noted. Some of the bill's terminology is so general that the precise effect is in doubt. For example, is an airplane "a product . . . [which] may cause death or serious injury . . ."? Nor is its effect on exist-

*Indeed, one should also ask why some corporations are apparently excluded from coverage by the bill. As introduced in the House, it applies only to "manufacturing, mining, retailing and utility corporations." It would not seem, for example, to apply to the broadcast media, a rather odd exemption in light of the claim that this legislation is necessary to reduce the influence of large corporations on American social, political, and economic life.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

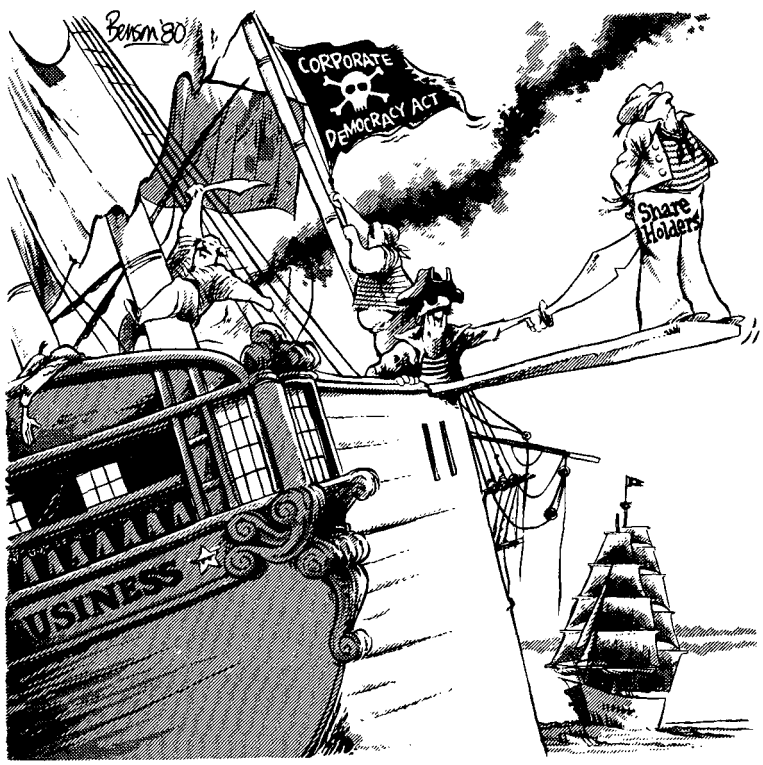
ing law in areas such as a director's duty of care clear. In fact, it seems to have been drafted by persons whose knowledge of existing law is sparse. For example, the bill seems to assume that corporate political contributions to candidates for federal office are legal.

Shareholder Power—A Shopworn Idea

Such relative refinements aside, however, the proposed legislation is fundamentally wrongheaded in what it seeks to achieve. So far as shareholder protection is concerned, the "problem" to which the bill is directed is an artificial creation of those who chronically favor contraction of the private sector. Proponents of the proposal want us to believe that Mark Green and the Building and Construction Trades Department, AFL-CIO, are the champions of private investors. The only senator to come to the rescue of shareholders is Howard Metzenbaum (Democrat, Ohio), while in the House of Representatives their protector is Benjamin Rosenthal (Democrat, New York), both of whom are among the most persistent critics of profit making in the private sector. That investor protection is a goal of the corporate democracy bill simply cannot be taken seriously.

Both the theoretical basis and the practical need for federal entry into this new field are illusory. The former consists of the antique notion that the chartering of corporations represents the conferral of some sovereign prerogative, which the states are bestowing improvidently. In fact, however, states "grant" nothing. A corporate charter is no more than a private contract recorded in a state office for the protection of third parties. The state plays exactly the same role as it does in the case of home mortgages, for which it provides a statutory code of general provisions and a place to record private contracts.

As for the asserted practical need for federal intervention: That consists of the discredited notion that Delaware and other states tilt their corporation codes in favor of management and against shareholders. Even on its face, such a proposition is implausible. Investors need not purchase common stock at all, much less stock in Delaware corporations. They can invest their funds in bonds, partnerships, individual proprietorships, short-term paper, real estate, stock in foreign corporations, or even indulge in present consumption. Nor do underwriters have to participate in stock issues by Delaware corporations or brokers have to recommend such stock. It is simply absurd to think Delaware can monopolize international capital and that Saudi sheiks are forced to sacrifice their petrodollars to greedy managements freed by Delaware law to bilk stockholders. If Delaware were in fact to tilt its laws toward management, the sole result would be to impair the access of corporations chartered there to the capital market. It is simply inconceivable to think that underwriters and investment counsellors would not impose heavy burdens on stock offerings made under a corporate code unfair to shareholders. States that offered bet-



"Trust me, mate."

© 1980, Regulation Magazine

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ter gains to shareholders would in fact get the most corporate charters. If anything, competition for charters leads to corporate codes that optimize the shareholder/management relation.

Limiting management discretion to act without formal shareholder approval is a shopworn idea that collides, each time it comes by, with the same harsh reality: shareholders do not want more "power." Shareholders generally have neither the time nor the desire to participate in management; when they are dissatisfied they prefer simply to sell their stock in the company. Indeed, state law frequently will not respect shareholder votes that ratify management conduct precisely because those votes are meaningless. Shareholders understandably view themselves as investors—like bondholders, but with a more volatile stake in the firm. In fact, one of the great contributions of the corporate form has been to permit the separation of equity investments from the responsibilities of control.

Existing voting rights in common stock play a critical function, because they blend the investment market with a market for control that permits takeovers. If management is inefficient, earnings will suffer and the price of stock will fall. This will create incentives for attempts (by way of merger, tender offer or, less frequently, proxy fight) to replace management through a shareholder vote and thereby reap a capital gain from the increased efficiency of the firm. The market for control thus gives management good reason to keep the corporation's stock price relatively high, a goal consistent with the well-being of shareholders. The provisions of the Corporate Democracy Act are irrelevant to this aspect of voting rights—the only aspect that significantly matters.

Of course, the recent flap over shareholder "power" has nothing to do with investor welfare. Rather, it is an attempt to construct legal procedures which allow small groups that have failed to achieve their goals through the democratic political process to continue to pursue those goals by embroiling management in time-consuming and highly publicized disputes. Although sizable numbers of shareholders are almost never involved, management's desire to avoid controversy often caps such movements with success in affecting corporate conduct.

The bill's attempt to strengthen shareholder "power" is not just meaningless. It would also be harmful. Shareholder votes are often cumbersome and require considerable legal advice given at the highest rates. Moreover, the bill seems to outlaw the use of different classes of stock; such a restriction, by reducing the flexibility of terms on which new investors can be admitted, would impair a corporation's access to capital markets. Finally, opening up the mechanisms of corporate governance to political zealots who have failed to win support for their causes would weaken the institutions and processes by which political majorities govern.

The attempt to strengthen the board of directors is an error in other ways. The bill would reduce the number of persons eligible for membership on boards by limiting the number on which one person may serve. The authors of the legislation no doubt regard financial experience and technical knowledge as of little importance, if not positively harmful, and foresee no problem in finding qualified people. In fact, the pool of people qualified to perform the functions of a strengthened board is necessarily limited so that, to limit it even further, might affect corporate performance adversely.

A strengthened, active board, moreover, is hardly more "democratic" or "independent." Deeper involvement in the ordinary affairs of corporations would require that directors spend more time and receive higher fees. The "independent" directors would thus become management in all but name.

More Burdens and Dangers

The Corporate Democracy Act also purports to give "affected communities" better information on the impact of corporate decisions. What this means, it turns out, is the imposition of financial penalties on firms that decide to shift the locale of certain corporate activities. Not only would such corporations have to continue to pay local taxes and wages to laid-off employees for a period of time but they would also have to give two years' notice of the move. Such notice would in most cases drastically impair the ability of the firm to operate efficiently during the intervening years. (See also Richard McKenzie's article, page 32, this issue.)

This aspect of the bill is, of course, outright protectionism—the functional equivalent of a tariff and just as detrimental to consumers.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The "affected community" to which the corporation was going to move and the potential employees living there are left out in the cold, and the cost reduction that would benefit consumers is prevented. Economic mobility is in the society's interest and, if individual hardship requiring remedial aid results, the proper remedy is not a protectionist law penalizing that mobility but transitional government aid.

So far as corporate disclosure is concerned, there is already an enormously burdensome tax imposed by the federal government in the form of paperwork. If anything, investors want less of this, not more. The bill's wholesale reporting requirements would produce only increased costs, a mountain of unread material, and socially useless litigation. Expansion of reporting requirements should occur only in connection with an articulated governmental policy administered by a relevant government agency. In that way, the overall burden of disclosure requirements could be more easily identified and taken into consideration. Calls for public reporting on every matter that happens to occur to corporate critics will inevitably increase costs without corresponding benefits.

The Corporate Democracy Act also prohibits the discharge of any employee except for "just cause." On a rhetorical level, that seems simple justice. As a legal proposition, it is disastrous. In effect, every employee would be given tenure and, to justify a discharge, serious misconduct or deficiency would have to be proven in legal hearings entailing vast amounts of time and expense. The fact that better workers might be available would be irrelevant. The model for this provision is the civil service—which, these days, is generally not thought of as a model for anything else. In some parts of the country, where tenure provisions like those contained in the bill protect public school teachers, private schools paying much lower salaries than their public counterparts have much better teaching staffs because they have the unlimited power to hire and fire.

The bill also provides a variety of expanded penalties for violation of vaguely defined state or federal laws. This wholesale approach has great danger, because its impact cannot possibly be assessed. Hundreds of laws might be affected—which ones cannot be identified in advance, given statutory language whose lack of precision is exemplified by "an offense resulting in . . . damage to the natural environment." In truth no one can assess the impact of such provisions until years of litigation have passed. Since there is an easy and sensible alternative—varying the penalties available under particular existing laws—this part of the legislation has absolutely nothing to recommend it.

The Love Canal of the New Class

The proponents of the Corporate Democracy Act have done a disservice to the nation. Instead of focusing on real problems and suggesting remedies tailored to those problems, they have adopted a wholesale, punitive approach accompanied by strident rhetoric ("crime in the suites") designed to appeal to base emotion. The very real problem of proliferating state anti-takeover statutes designed to insulate the managements of local firms from the market for corporate control is disregarded in favor of calls for more power to shareholders who do not want it and will not use it. The problem of reducing the destabilizing effects of economic mobility on individuals is ignored in favor of attempts to restrict the mobility itself. What may be a need for more corporate disclosure is lost in demands for the production of every piece of information that might interest the corporate critics, regardless of the cost society would ultimately have to bear.

If we have learned anything from the professional corporate critics in the past, it is that their animus against the private sector is so intense that they cannot be trusted to address real problems sensibly. At one time, a staple of their proregulation rhetoric was flammable children's sleepwear. When government solved that problem in a fashion that ultimately resulted in expensive carcinogenic pajamas, the critics continued to attack the manufacturers. Gas-guzzling antipollution and safety devices were heaped upon cars at the behest of corporate critics without regard to fuel consumption, but when the energy crisis hit, car manufacturers and oil companies were said to be at fault. The critics' present remedy for that crisis is to keep gas prices low to prevent corporate price "gouging"—the most effective device known to human kind for encouraging consumption. The Corporate Democracy Act comes from the same crowd, and goes in the same unthinking direction. It is the Love Canal of the New Class. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

What Is True Corporate Responsibility?

Murray L. Weidenbaum

Big Business Day (April 17) proved to be the dud that its ill-assorted guard of sponsors invited—and richly deserved. Yet its ostensible concern about the role of the corporation in modern society remains to be dealt with, albeit in a more constructive way. In that spirit, let us consider the concept of "social responsibility" on the part of companies that supposedly—or so say the relatively responsible critics—concentrate too single-mindedly on maximizing profits.

How *should* the performance of business firms be evaluated? Brushing aside the theatrics of the Jane Fondas and Ralph Naders, we find striking similarities among the more serious scholars. That is, most academic writers on "social responsibility" view the corporation almost solely as an engine of income redistribution, as a community benefactor, as a mechanism for improving the "quality of life," both on and off the job—in short, in terms of its contributions to specific social or eleemosynary objectives.

But perhaps I am trying to state the point too subtly. My concern is not with the notion of paying some attention to the social dimensions of the business firm but with our growing habit of treating these noneconomic factors as paramount, sometimes I suspect unwittingly. Thus, traditional economic or business functions are so frequently viewed as secondary, or taken so much for granted, that the basic business of business is ignored by those outside the corporation who are evaluating its behavior. (Still in my unsubtle mood, let me note that "profit maximization" is itself shorthand for much, much more—for job creation and increases in productivity, for meeting payrolls, distributing dividends, and paying taxes.)

Surely the social impacts of business merit attention. We care about the air we breathe, the water we drink, and how the quality of both are affected by the actions of others. But, as citizens of the society, we have a wider array of concerns—economic as well as noneconomic.

To illustrate the point being developed here, let us conjure up two companies of similar size (measured by assets and sales) and in the same industry (say, pharmaceuticals): one is Social Responsibility Inc. (SR Inc.) and the other, Profit Maximization Inc. (PM Inc.). Let us further postulate that both SR Inc. and PM Inc. are law-abiding corporate citizens. Both operate at levels of honesty and integrity at least equal to those of government agencies, college professors, and social activists.

SR Inc. is the type of firm that meets all of the textbook criteria for social responsibility and even elicits admiration from Ralph, Jane, et al. It regularly fulfills its affirmative action "targets"; it goes beyond that and maintains special training programs to accelerate the career development of each minority and female member of its work force. SR Inc. is also a bulwark of its local community, supporting generously a variety of activist "citizen" groups as well as the opera, the art museum, the ballet, the symphony, and Scouts, Boy, Girl, and Sea. SR Inc. prides itself on the safety of its work places (it has never received so much

Murray L. Weidenbaum is J. E. Lundy visiting scholar at the American Enterprise Institute, on leave from Washington University in St. Louis.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

as a *de minimus* citation from OSHA) and of its products (there has never been a product recall in its history). In fact, the Sierra Club and the Friends of the Earth regularly use the company's auditorium for their meetings, free of charge, of course (including the granola-nut cookies and all-natural apple cider).

Profit Maximization Inc., on the other hand, is a very different breed of cat. It refuses to take government contracts and so avoids any requirement for conducting an affirmative action program. Rather, it hires and promotes solely on what its personnel office describes as outstanding professional merit. PM Inc. rarely contributes to local charities. It also has been chided by OSHA for failing to post the required notices and for maintaining inadequate safety records. On occasion, some of its products have been recalled for adverse side effects, albeit of the nonfatal variety.

Ecologists consider PM Inc. to be unfriendly because it obeys EPA mandates only grudgingly and after exhausting all available administrative and judicial remedies. And, to complete the catalogue of venality, let us assume that, although the firms are of equal size, PM Inc.'s profits are double those of SR Inc.

Quite clearly, these two firms are at opposite ends of anybody's scale of social responsibility. SR Inc. is a ten and PM Inc. is a zero. Well, almost anybody's. Let us try to break new ground and go beyond the traditional notions of social responsibility. Let us, therefore, examine the economic functions of these two companies, remembering that both are producers of pharmaceutical products.

As it turns out, SR Inc. manufactures and markets an array of old-line, standard, tried-and-true prescription drugs used to treat routine ailments. This helps, of course, to account for its fine safety record, as well as its low profitability—and its slow growth in sales, employment, dividends, and taxes paid.

PM Inc., in contrast, concentrates on developing new medicines, especially those that can be used for curing major diseases not much responsive to traditional pharmaceuticals. PM Inc.'s work force of brilliant male WASP scientists constantly wins prizes for achieving a variety of scientific breakthroughs that result in lifesaving—*and* rapidly selling *and* highly profitable—new medicines. (The reader can readily think of similar contrasting examples in other industries, but the point need not be belabored.)

Now, until these two stereotypes are more fully fleshed out, some of us may be reluctant to state categorically that PM Inc. contributes more to the public welfare than SR Inc. But I, if pressed, surely would opt for PM Inc. By ignoring the merit of the "economic" functions of the business firm, most available analyses of corporate social responsibility are fundamentally flawed. At the least, they are inadequate to the extent that they implicitly assume that the act of producing and distributing food, clothing, shelter, and other necessities and amenities has little bearing on society's welfare. PM Inc. should not be a zero on anybody's scale of social responsibility.

To reduce the likelihood of being misunderstood, let me repeat the basic thesis of this article: the role and contribution of the business firm in modern society should not be viewed *primarily* in noneconomic terms. As an economic unit, if the business firm has any fundamental obligation to the society of which it is a part—aside from or even in contrast to its commitments to its shareholders—it is to produce those goods and services that consumers desire in order to enhance their welfare as they see it. Conventional notions of "social responsibility" should properly be viewed as constraints rather than basic goals to be aimed at.

The contributions of business to meeting other concerns of society are surely not trivial. But clearly they are ancillary. Perhaps we need to go a step further and point out that the business firm is not an all-purpose mechanism. It is an economic organization that was created for and is best suited to serve economic purposes —purposes, moreover, that are of vital importance to the health and welfare of the society.

The implications of all this may even be profound! To the extent that the basic role of the corporation is excluded from the analysis, the analyst will be led to question the "legitimacy" of the corporation and to conclude that society's will must be more directly imposed on these private mechanisms. And the analyst will be misled. A comprehensive and balanced analysis is more likely to conclude that the business firm, warts and all, is a major bastion of our free and productive society. Thus, the proper response to Big Business Day may well be—"Free the Fortune 500!" ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Frustrating Business Mobility

Richard B. McKenzie

BUSINESS MOBILITY—the mirror image of the free play of economic forces—is a normal, indeed inevitable, feature of any dynamic and growing economy. Nonetheless, particular moves (plant closings, relocations, and the like) can and do evoke protests by the communities and workers left behind. They see themselves as somehow "wronged." And among the political remedies they seek are restraints on business mobility by government fiat.

Cities are worried about losing employers and tax revenues to the suburbs, the Snowbelt is worried about losing both of those and skilled workers as well to the Sunbelt, and politicians everywhere seem attracted to the notion that economic stability in their areas can be ensured by putting a check on management's freedom to pull up stakes. Two years ago when American Airlines announced its decision to move its headquarters from New York to Dallas, for example, New York Mayor Edward Koch termed it a betrayal, and a taxi union vowed to stop serving the airline's New York terminals. Fortunately for the airline and its passengers, as well as the cabbies, the threat was never made good. And American's headquarters was moved.

In recent years, bills that would seriously restrict business mobility have been introduced in the U.S. Congress and a number of state legislatures.* The scheme is also the centerpiece of Ralph Nader's current campaign to "democratize" corporate America, to make major corporations more responsive to the "general interest." (His vehicle is the Corporate Democracy Act of 1980, H.R. 7010.) If such a measure became federal law, it would substantially increase government intervention in business decision making, alter our national economic system in fundamental ways, and be, on balance, detrimental to the regional and local economies of the country in the bargain.

Richard B. McKenzie is professor of economics at Clemson University. *This article is an updated summary of the author's* Restrictions on Business Mobility: A Study in Political Rhetoric and Economic Reality (*Washington, D.C.: American Enterprise Institute, 1979*).

The "Runaway Plant Phenomenon"

The general purpose of the restrictive legislation, which already has been enacted in Maine, is to remedy what has been called the "runaway plant phenomenon." Typically, the bills provide for a government agency to investigate business moves and rule on their appropriateness. For example, the National Employment Priorities Act, a 1977 proposal that was reintroduced in the House last August, by Representative William Ford (Democrat, Michigan) and sixty-one co-sponsors, would set up a National Employment Priorities Administration within the U.S. Department of Labor to investigate plant closings, to report its findings on the economic rationale for the decision and on employment losses and other impacts on the affected community, and to recommend ways of pre-

*At last count eleven, including the northeastern states of Connecticut, Maine, Massachusetts, New Jersey, New York, Pennsylvania, and Rhode Island, plus Illinois, Michigan, Ohio, and Oregon.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

venting or mitigating these harmful effects. (In the 1977 version, the investigation would determine whether "such closing or transfer" was "without [and presumably also "with"] adequate justification.") A bill pending since 1978 in the New Jersey General Assembly would vest similar responsibilities in a state agency called the Division of Business Relocation.

A second typical feature of bills designed to curb business mobility is the levying of penalties on firms that move. The Ohio bill, for instance, would require such firms to dole out to the employees left behind severance pay equal to one week's wage for each year of service and to pay the community an amount equal to 10 percent of the gross annual wages of the affected employees.

Under the Ford bill (H.R. 5040), a business that moved or closed would have to pay the workers left jobless 85 percent of their last two-years' average wage for a period of fifty-two weeks, less any outside income and government assistance. Besides, the firm would have to make a year's normal payments to any employee benefit plan and cover relocation expenses for employees who decided to move to any other company facility within the next three years. Workers over age fifty-four at the time of a move or closing would be entitled to full retirement benefits at age sixty-two instead of sixty-five or seventy. Failure to comply with the act would carry severe penalties—a combination of fines and the denial of tax benefits associated with a move. Finally, the local government would be owed an amount equal to 85 percent of the firm's average tax payments for the last three years. If the firm moved abroad and an "economically viable alternative" existed in the United States, the firm would have to pay "damages" equal to 300 percent of any tax revenue lost to the U.S. Treasury. Any payment required under the act, not met by the firm, and paid by the federal government would become a debt owed by the firm to the federal government.

Third, the kind of legislation under consideration here generally provides for government assistance to the people and entities adversely affected. Under the Ford bill, for instance, the U.S. secretary of labor, with the advice of a relocation advisory council, would be empowered to provide financial and technical assistance to employees who lost their jobs, to the communities affected by plant relocations, and even to businesses themselves—those that might decide *not* to relocate if government assistance were available. Assistance to employees would take the form of training programs, job placement services, job search and relocation expenses, in addition to such existing welfare benefits as food stamps, unemployment compensation, and housing allowances. Federal grants for additional social services and public works projects would go directly to the community. Assistance to businesses would be given as technical advice, loans and loan guarantees, interest subsidies, and the assumption of outstanding debt, but only if the secretary of labor were to determine that the aid would "substantially contribute to the economic viability of the establishment." The New Jersey and Ohio proposals provide for similar community and employee aid.

Fourth, under the various bills, firms are required to give advance notice of their plans to move or close—up to two years' notice in the Ohio bill and in the proposed Corporate Democracy Act of 1980. The prenotification requirement in the Ford bill varies with the size of the anticipated loss in jobs: two years for firms expecting the loss to be greater than 500, one year for 100 to 500, and six months for less than 100. The legislation proposed in New Jersey requires only a one-year notice. Exceptions could be made, of course, but generally only if the firms can show that meeting the requirement would be unreasonable.

Fifth, the various bills usually require that businesses offer their employees, to the extent possible, comparable employment and pay at the new location. And finally, each of the bills contains some minimum-size cutoff point. The proposed National Employment Priorities Act, for example, would apply only to firms with more than $250,000 in annual sales. But it should be noted that many McDonald's restaurants do that much business in a year. The bills' reach, typically, is both wide and deep.

Drawing the Battle Lines

In describing the changing regional structure of the U.S. economy, *Business Week* magazine observed: "The second war between the states will take the form of political and economic

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

maneuver. But the conflict can nonetheless be bitter and divisive because it will be a struggle for income, jobs, people and capital" (May 17, 1976). And so it promises to be. When he introduced the original National Employment Priorities Act in 1977, Representative Ford gave us a preview of the economic rationale of the political battle lines and some flavor of the ensuing debate:

> The legislation is based on the premise that such closings and transfers may cause irreparable harm—both economic and social—to workers, communities, and the Nation.... My own congressional district suffered the effects of the runaway plant in 1972 when the Garwood plant in Wayne moved and left 600 unemployed workers behind.... [T]he reason these firms are moving away is not economic necessity but economic greed. For instance, the Federal Mogul Company in Detroit signed a contract in 1971 with the United Auto Workers and 6 months later announced it would be moving to Alabama. A spokesman for the company was quoted as saying that they were moving "not because we are not making money in Detroit, but because we can make more money in Alabama."

Two years later, in introducing his significantly revised 1979 bill, Representative Ford stressed that business movements from the Northeast during the last decade had resulted in a million lost jobs in manufacturing and pointed to studies showing the suicide rate among workers displaced from their jobs by plant closings at thirty times the national average. He also noted,

> It is well established that the affected workers suffer a far higher incidence of heart disease and hypertension, diabetes, peptic ulcers, gout, and joint swelling than the general population. They also incur serious psychological problems, including extreme depression, insecurity, anxiety, and the loss of self-esteem.

A veritable chamber of horribles!

So it should come as no surprise that the campaign for government restrictions on business mobility adopts the rhetoric of war. Phrases like "second war between the states," "counter-attacks," and "fierce and ruinous state warfare" fill popular accounts of regional shifts. The economic conflict at the heart of attempts to control business relocations is viewed as "us" against "them"—North versus South, the Snowbelt versus the Sunbelt.

Such rhetoric may serve transient political purposes. But it distorts public perception of economic conditions in different parts of the country and hides nonsensical arguments behind the veil of "urgency" as to government action. Thus, it is instructive to examine the major arguments made to support restrictive legislation.

Changes in Population

The contention is made that southward business movements have increased the rates of population growth in the South and Southwest. The corollary is that the North is actually losing people, especially highly educated workers, and that the population shifts that have been occurring are larger than can be accommodated by existing political institutions.

What do the data actually show? First, as is evident in Table 1, the population growth rates of the Northeast and North Central regions have indeed declined significantly since the 1950s, but so have the population growth rates of *all* regions, including the South and West. (Only the Middle Atlantic states experienced a net decline in the 1970–1977 period, and that decline was very modest.) Further, and here Table 2 is in point, these changes in population growth rates have been caused as much or more by "natural" factors—changes in fam-

Table 1
POPULATION GROWTH RATES, BY REGION, 1950–1977

Region	1950–1960	1960–1970	1970–1977
Northeast	13.2%	9.8%	0.4%
New England	12.8	12.7	3.3
Middle Atlantic	13.3	8.9	−0.4
North Central	16.1	9.6	2.3
East North Central	19.2	11.2	2.0
West North Central	9.5	6.1	3.4
South	16.4	14.3	11.2
South Atlantic	22.6	18.1	11.8
East South Central	5.0	6.3	8.0
West South Central	16.6	14.0	12.3
West	38.9	24.2	12.7
Mountain	35.1	20.9	21.0
Pacific	40.2	25.2	10.1
U.S. Total	18.5	13.4	6.4

Source: Adapted from Richard B. McKenzie, *Restrictions on Business Mobility* (Washington, D.C.: American Enterprise Institute), Table 1.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Table 2
AVERAGE ANNUAL GROWTH RATES IN POPULATION BY REGION AND CAUSE, 1960–1970 AND 1970–1976

Region	Population		Natural Increase		Net Migration	
	1970–1976	1960–1970	1970–1976	1960–1970	1970–1976	1960–1970
Northeast	0.1%	0.9%	0.4%	0.9%	−0.3%	0.1%
North Central	0.3	0.9	0.6	1.0	−0.3	−0.1
South	1.5	1.3	0.8	1.2	0.7	0.2
West	1.6	2.2	0.8	1.3	0.8	1.0
U.S. Total	0.9	1.3	0.7	1.1	0.2	0.2

Source: McKenzie, *Restrictions on Business Mobility*, Table 2.

ily life styles, the costs of rearing children, the widespread use of contraception, and the legality of abortions—as by net outmigration.

Second, aggregate data on population shifts blur the complex picture of who moves and for what reasons. Many of the people who moved south in the 1970s are the same people who moved north in the 1950s and 1960s. Others (for example, retirees) have moved south for reasons wholly unrelated to business location. Still others have moved because of new and expanding industries in the South, not because of relocations from elsewhere. It is also interesting to note that a major source of the above average population growth of the South Atlantic states (11.8 percent in the 1970–1977 period) has been the extraordinary growth of a single state, Florida (over 25 percent).

Third, a favorite argument in support of restrictions on business mobility is that the South and West are gaining a disproportionate share of highly educated and highly skilled workers, leaving the North and Midwest with a preponderance of uneducated, unskilled, and thus low-income workers. Now, the new wave of outmigration from the North of course includes many highly educated and skilled people; but the proponents of restrictive legislation greatly exaggerate the quite undramatic facts. For instance, in the 1975–1977 period substantially more unemployed male workers moved from the Northeast to the South (23,000) than from the South to the Northeast (14,000), and virtually the same pattern held for unemployed female workers. (The Northeast also exported more unemployed workers to the West than it imported from the West.)

Other considerations are equally revealing. Far more people below the poverty line migrated from the Northeast to the South (133,000) than vice versa (39,000) in the 1975–1977 period. (Much the same point can be made about the migration of low-income people between the Northeast and West.) In addition, while more people with one or more years of college migrated from the Northeast to the South (151,000) than from the South to the Northeast (102,000), those with *some* college education were a significantly greater proportion of the southern migrants to the North (56.3 percent) than the other way around (40.3 percent). (The same cannot be said about the migration of college-educated people between the Northeast and the West.) In short, it simply is not clear that the South or the West is receiving from the North a disproportionate number of highly trained, high-income people. Some—but no tidal wave.

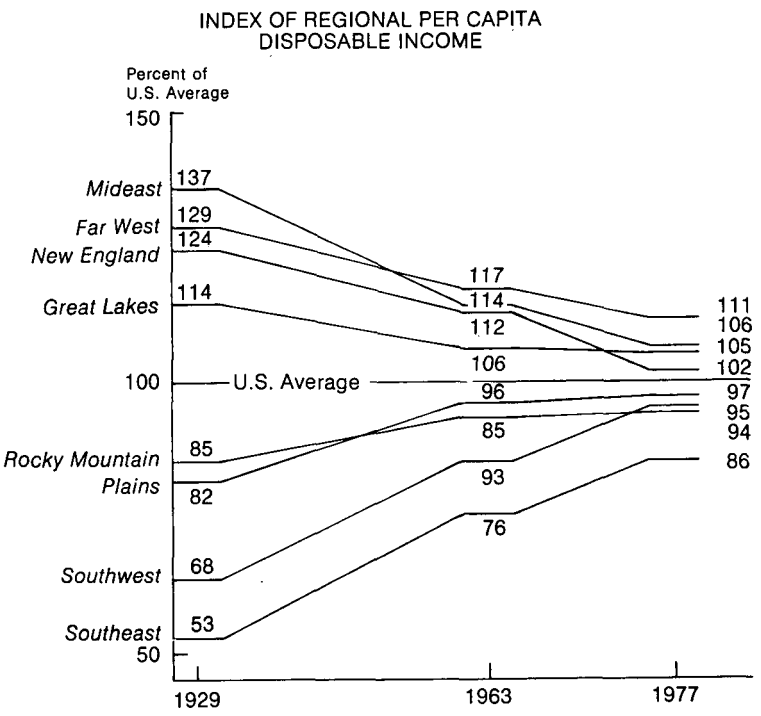
Finally, most people move within a region, not among regions—and mostly they stay within the same state. Indeed, of the people who moved to a different house in the 1975–1977 period, approximately 60 percent stayed in the same county! Hence, if business relocation rules are seen as a means of restraining migration, *and insofar as migration results from business relocations at all*, these rules will in fact restrain migration *within* regions and states more than *among* regions. And insofar as such rules are designed to retard the economic development of the South and West by restricting the migration of people and jobs, it follows in all likelihood that they also will restrict the economic development of *all* regions, the North along with the rest.

Hence, if business relocation rules are seen as a means of restraining migration, . . . these rules will in fact restrain migration within regions and states more than among regions.

Changes in Income

Edward Kelley, in a position paper of the Ohio Public Interests Campaign, claims that business movements are reducing individual incomes and the tax collections of governments

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



Source: Calculated by Yale Brozen, Department of Economics, University of Chicago.

in the North: "As the manufacturing base of the [northern] economy declines, so does the tax base. There are fewer taxable industrial locations and fewer people paying taxes" (*Industrial Exodus: Public Strategies for Control of Runaway Plants*, 1977). Yet in fact individual incomes in the North have been rising over the years. It is also true that individual incomes have been growing faster in the Southeast, Southwest, and West. What is happening, as the accompanying figure clearly shows, is that the relative incomes of the regions are converging. Personal income in the North has decreased relatively (while increasing absolutely), but it still averages 25 percent higher than personal income in the South. In short, if business movements owe something to the disparity in regional incomes and if regional incomes are converging, it would seem that Representative Ford and Mr. Nader have proposed a solution to a problem that is being solved anyway, and predictably so, by normal market forces. In fact, because of the convergence of regional incomes, business mobility is likely to be less dramatic in the future than it was in the past.

. . . it would seem that Representative Ford and Mr. Nader have proposed a solution to a problem that is being solved anyway . . . by normal market forces.

The movement of businesses to the South does not necessarily mean that the North is made worse off, absolutely, or that improvement in living standards there has been retarded. Indeed, the converse may be reasonably argued—namely, that the movement of people and industry south has contributed to an improved standard of living in the North. By moving south where production costs are lower, businesses are able—at least in the long run—to provide goods to northern markets at lower prices than if they had stayed in the North. And they can expand production at lower cost. In not too many years, this increases both national income and, because the prices of goods are lower, the purchasing power of *all* workers' incomes, including those in the North.

The Decline in Northern Manufacturing Jobs

The claim that the North has lost a million or so manufacturing jobs in the last ten years suggests an economic problem serious enough to justify severe restrictions on entrepreneurial freedom. In fact, however, the claim misinterprets the actual state of employment opportunities in the North. The narrow focus on *manufacturing* employment hides the very important fact that *total* employment in the North has risen continually and significantly during the last several decades.

As Table 3 shows, manufacturing employment in the Northeast and East North Central regions did indeed decline by about 1 million jobs between 1969 and 1979; but in the same period total nonagricultural employment grew substantially, by 4.5 million jobs, reflecting the strong upward trend in service and government employment during the period. Moreover, since 1975 even manufacturing employment in the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Table 3

NONAGRICULTURAL EMPLOYMENT IN THE NORTHEAST AND EAST NORTH CENTRAL REGIONS, 1965–1979

(In thousands)

Year (monthly average)	Total Employment	Manufacturing Employment
1979 (Dec.)	38,100	10,172
1978	36,331	10,153
1977	35,408	9,886
1976	34,288	9,601
1975	33,376	9,396
1974	34,826	10,423
1973	34,506	10,533
1972	33,358	10,093
1971	32,803	10,027
1970	33,249	10,936
1969	33,358	11,201
1968	32,384	11,055
1967	31,589	11,007
1966	30,867	11,034
1965	29,464	10,472

Note: The Northeast and East North Central regions include Maine, Vermont, New Hampshire, Connecticut, Rhode Island, Massachusetts, New York, Pennsylvania, New Jersey, Ohio, Indiana, Illinois, Michigan, and Wisconsin.

Source: *Statistical Abstract of the United States*, 1965-1977, and *Employment and Earnings*, 1978 and 1979.

North has begun to move up again. If business relocation rules are designed to thwart the movement of manufacturing jobs generally, they may well have the ironic effect of choking off this recent reversal of the long-term downward trend in northern manufacturing jobs.

. . . it must be stressed that only a very small percentage of the 1 million lost manufacturing jobs in the North can be attributed to business migration. . . .

Finally, it must be stressed that only a very small percentage of the 1 million lost manufacturing jobs in the North can be attributed to business migration in any case. A study by Peter Allaman and David Birch of the Massachusetts Institute of Technology shows that just 1.5 percent of the North's job losses in the 1969–1972 period stemmed from the outmigration of firms, while a recent extension of that study by James Miller of the Department of Agriculture puts the figure at 1.6 percent for the 1969–1975 period. In other words, as Miller concluded, the impact of firm migration on the reallocation of manufacturing employment among regions "was trivial compared to the net effect of starts, closures and stationary firms."

An added inducement to this alleged movement south, it is often argued, is the "wage-attraction" of the South. However, it is more illuminating to assess the impact of "wage-push" in the North. From the wage-attraction perspective, it may appear that low-paid workers in the South are stealing business from and causing economic harm to the North. But the wage-push perspective suggests that wages in the North are higher and on the rise for such classical economic reasons as competition for workers from the developing service sector in the North. In other words, manufacturers are forced to pay higher wages or risk losing their labor force to more rapidly expanding sectors of the economy. Firms that move south are "pushed" south, having been outbid for labor resources in the North. From this perspective, industrial movements to the South are a consequence of gains made by many workers in the North—and the "runaway plant phenomenon" is a positive force in the dynamic and growth economy, South *and* North.

Even if northern manufacturing firms were to be restricted from moving south by legislation, the movement of manufacturing jobs to the South, though impeded, would not be stopped. Firms move because costs of production in the new location are lower—and anticipated profits higher. Restrictions on business mobility would cause new firms to spring up in southern locations and existing southern firms to expand by more than they otherwise would. Because of cost disadvantages, firms in the old northern locations would be induced by natural market forces—*which relocation rules attempt to override*—to contract their operations or to go out of business.

Comparative Cost Advantages

And this of course is the key, this ill-conceived attempt to improve on "nature" by those who urge regulation to restrict business mobility. Even at the risk of accentuating the obvious, it is helpful to return to a first principle or two. People in different parts of the country trade with one another because differences in their costs of production make it to their mutual advantage to do so. Specialization in trade leads to maximum output from the resources available to the community as a whole. And, because the conditions of production—the avail-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ability of resources, technology, consumer preferences for work and for goods—continually change, so do the comparative costs from region to region. What once was relatively advantageous to produce in the North may, for any number of reasons, become less costly to produce in some other region. This constantly shifting calculus of costs can be altered by changes in the relative scarcity of resources, worker education levels, or regional preferences for services. Whatever the reason, the cost of producing any particular good in one region can go up and, as a consequence, the production of that good moves elsewhere—all, to repeat, very "naturally."

Pinning down the precise reasons for changes in regional economic structures is difficult in the best of circumstances. In recent decades, however, the comparative advantages of the North have indeed changed, and for two principal reasons. First, the demand for services in the North has increased rapidly, more so than in other parts of the country; and this in turn has increased the cost of resources, including labor, for all other sectors of the northern economy. Also, environmental legislation has placed more severe restrictions on industrial production in the congested North than in many other parts of the country and has increased the relative costs of manufacturing there. The unavailability of "pollution rights" in the North has caused many firms to look to locations with less present pollution and less stringent immediate pollution-control standards—to the South and West, for example.

Undeniably, these changes in regional production costs, and the economic adjustments that result from them, can and do cause hardship for some. But restricting business mobility is a cure worse than the disease. Such restrictions would force employers to lock labor and other resources into comparatively inefficient uses—resources that could and should be moving into expanding sectors of various regional economies. Thus, governmental rules that impede the movement of manufacturing industry out of the North would not only retard the development of industry in the South (or elsewhere) but, by the same token, would retard the development of the service sector in the North. The overall result would be increased nationwide production costs and reduced national production and income.

The Worst of Worlds

States and communities that are mulling over business mobility restrictions may believe they would be protecting their economies by protecting their industrial bases, but in fact they would be hurting them—and themselves. What company would want to move into an area that had substantial economic penalties for moving out? What entrepreneur would want to start a business in a community or state that had penalties for changing locations? Companies interested in profits will always try to settle in those areas that leave them free to make the basic decisions on when to shift among products, when to close, and when to move. States or communities that do not impose restrictions will obviously have a competitive advantage over those that do—which makes it equally obvious why Representative Ford and others, who want restrictions in their own areas, are seeking through federal legislation to have *all* areas of the country abide by the same rules. And this simply tightens the squeeze on U.S. industry in world markets and provides yet another marginal inducement for U.S. firms to locate their production facilities in foreign countries where such restrictions are not in place.

What company would want to move into an area that had substantial economic penalties for moving out?

Indeed, viewed from whatever perspective, restrictions on business mobility constitute an idea whose time one hopes will never come. Predictably, restrictions would tend to reduce the efficiency of resource allocation; reduce national and regional income levels; and reduce the ability of the economy to respond to changes in people's tastes and to changes in technology, in the availability of resources, and in the mix of demand for particular goods and particular services. In short, they represent a bad bargain all around—for the communities and workers affected (in spite of the appearance of near-term relief), for Representative Ford's constituents as much as everyone else, for the U.S. economy generally, for entrepreneur and taxpayer alike. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Competition and Health Care

Planning for Deregulation

Clark C. Havighurst
Glenn M. Hackbarth

It was inevitable that Congress's deregulatory right hand would eventually challenge what its left hand had been doing for years to the health-care industry—gradually tightening the government's regulatory grip. The first evidence of the challenge was a series of amendments, adopted last October, to the National Health Planning and Resources Development Act of 1974. These amendments significantly alter the jurisdiction and mandate of the health-care system's planners and regulators and reopen the policy debate over competition's potential for allocating resources to, and within, the health sector.

Congress did not call for immediate deregulation of the health services industry in the 1979 health planning amendments. Nor did it wholeheartedly embrace competition as the solution to the problem of steadily rising health-care costs. Nevertheless, the amendments reversed the previously implicit assumption that competition had no constructive role to play in the industry. Indeed, Congress expressly declared its preference for allocating health services through market competition—rather than by planning and regulation—"wherever competition and consumer choice can constructively serve to advance the purposes of quality assurance, cost effectiveness, and access." Although this statement leaves unanswered the ultimate question of when competition may be helpful, by reopening that question the amendments overturned the working premise of previous policy development and laid a statutory foundation for expanding competition's role in the future. Previously an academic pipe dream, deregulation in the health services industry has suddenly become a possibility to be reckoned with.

The shift in Congress's attitude about competition is exemplified by a single sentence that appeared first in the Senate Labor and Human Resources Committee's report on the 1974 law and once again—but with a significant revision—in the committee's report on the 1979 amendments. Whereas the earlier report stated that "the health services industry does not respond to classic marketplace forces," the 1979 revision says that the industry "*has not to date* responded" to such forces (emphasis added).

Clark C. Havighurst is professor of law, Duke University School of Law. Glenn M. Hackbarth is research attorney, also at Duke University School of Law.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In other words, the committee now acknowledges the possibility that the market may have untapped potential that was overlooked in 1974. This theme runs throughout the legislative history of the new amendments' procompetition language.

The 1974 Planning Act

In order to rationalize capital investment in health-care facilities and in the development of new health services, the 1974 health planning act established a two-tier process for screening proposed new investments. On the first tier are local, usually nongovernmental, *planning* agencies run by governing boards comprised of representatives of consumers and providers of health care. These so-called health systems agencies, or HSAs, develop "health systems plans" that (1) describe the locality's need for specific institutional health services and related facilities and (2) serve as the basis for HSA review of requests for certificates-of-need filed by those who wish to offer new or expanded services. The actual certificates-of-need are granted, however, by the second or *regulatory* tier of the two-tier structure. On this tier are state certificate-of-need agencies with minimum regulatory powers mandated by federal law, including the power to prohibit unapproved investments. The local health plans and HSA recommendations are expected, of course, to inform and rationalize regulatory decision making.

Congress erected this elaborate regulatory apparatus to curb two types of "unnecessary" investment. The first involves expenditures for redundant facilities or equipment. Health-care institutions "overinvest" in this fashion because government and private health plans (particularly Blue Cross plans) routinely reimburse those institutions for whatever costs they have incurred—often including the capital costs of empty beds and underutilized equipment. As a result, such institutions, particularly hospitals, are unduly free to err on the high side in estimating their future needs for bricks and mortar and new technology. With third-party payers helping to keep prices from falling below costs, hospitals are not penalized for creating excess capacity to the same extent as are firms operating in a more normal market. One result of this arrangement is the nation's surplus of hospital beds, which some experts estimate at more than 100,000.

Previously an academic pipe dream, deregulation in the health services industry has suddenly become a possibility to be reckoned with.

Possibly more costly to the public, however, is a second, less visible type of "unnecessary" investment—namely, investment in services or facilities that do not yield health benefits commensurate with their cost, even when they do not sit idle. Under the present financing arrangements, physicians and patients rarely have an incentive to make fine judgments about the cost-effectiveness of tests, therapies, or "new and improved" equipment. On the contrary, the prevalence of comprehensive, no-questions-asked insurance means that nearly full sway is given to the patient's urge to get the best possible care and the physician's urge to provide it. Indeed, nonprice competition, as well as a fear of malpractice claims if any stone is left unturned, drives providers to offer more and better services—more and better, that is, than the services people would rationally choose to purchase if they were spending their own money directly and were comparing benefits and costs.

Lessons from Regulatory Experience

Congress's willingness to contemplate a more market-oriented health policy is directly attributable to the fact that the regulatory strategy is in disarray. Existing regulation, which in some states includes hospital rate regulation as well as the entry and investment controls imposed by the federal planning law, has had only minimal success. Although regulators insist that a little more time, money, and jurisdiction will allow them to turn things around, their credibility wears thinner as health-care costs continue to escalate. It is ironic that regulation could probably have carried the day if only it had succeeded in stabilizing health spending as a share of GNP and federal spending. Con-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

gress's attention would then have wandered, even if the level of spending arrived at was horrendously inefficient—in the sense that many of those dollars could have been put to much better uses elsewhere in the faltering economy.

A closer look at the difficulties facing health planners and certificate-of-need regulators suggests why a strict regulatory regime for controlling health costs may be fundamentally flawed. First, "need" for a service or facility can seldom be determined with confidence. The precise benefits of particular diagnostic tools and therapies, even some that are long-established, are very often in doubt. Moreover, as evidenced by the nation's experience with the "new" health and safety regulation of the 1970s, a powerful taboo makes it difficult to undertake, or even acknowledge the existence of, trade-offs between the lives and health of citizens on the one hand and the public's finances on the other. Not surprisingly, then, politically exposed regulators find it hard to say "no" to even the very expensive investment that promises only marginally more effective care. They are particularly unlikely to do so if, as is usually the case, the financing system shifts much of the cost burden of the new investment to taxpayers and premium-payers outside of the regulators' local or state constituency.

Not surprisingly, then, politically exposed regulators find it hard to say "no" to even the very expensive investment that promises only marginally more effective care.

To be sure, some regulators have occasionally lined up support for tough, cost-conscious decisions by forging coalitions of business, labor, and "progressive" health-care providers. (In particular, such coalitions have slowed the growth in the already bloated stock of hospital beds.) More often than not, however, regulators are fighting a losing battle with the influential proponents of more and "better" care. Even when they reject proposals by existing providers (meaning hospitals, clinics, nursing homes, and so on), total costs may not be affected. For example, a hospital rebuffed on one proposal often comes back with another—if not for beds, then for something else—and eventually succeeds in tapping into the available funds. Or a rejected applicant may invest in equipment whose item-by-item cost is below the statutory threshold of the approval requirement. And even when certificate-of-need regulation does succeed in blocking inflation in capital costs, it cannot prevent the balloon from bulging elsewhere. Thus, hospital wages and personnel-to-patient ratios have risen persistently, reflecting what may be an inefficient, regulation-induced substitution of labor for capital.

If health planners and regulators have generally been liberal in granting certificates-of-need to existing institutions seeking to upgrade and expand their services, they have been relatively stingy about investments by would-be newcomers to the market. Unable to enforce economic discipline against their regulated constituency, they have often sought to demonstrate their resolve to avoid "duplication" of services by retarding the development of efficiency-enhancing competition—for example, from health maintenance organizations (HMOs), those potentially efficient prepaid health-care plans that care for an enrolled population within a fixed budget.

Of course, the strongly political character of planning and regulation, explicitly built into the HSA structure by "consumer" and "provider" representation requirements and implicit in state-level regulation, has encouraged decisions that reflect the interests of established providers. Health planners and regulators, even if they are not "captured" by the regulated institutions, may harbor a preference for stability and cooperative problem solving over what they see as an unruly competitive marketplace. Thus, they may protect providers from competition in order to gain their cooperation and support. Planners and regulators may also prevent "cream-skimming" by new competitors so that existing providers can continue to price some services above competitive levels. The resulting extraordinary profits may then be used to subsidize unprofitable services that the regulators deem desirable. Protectionist regulation is, in short, used to perpetuate internal subsidies, a regulatory practice that Richard Posner has labeled "taxation by regulation."

These reasons for protectionism are, of course, familiar to all students of economic regulation. However, the planners and regulators in this industry have additional, unique

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

reasons for adopting a protectionist stance, particularly toward hospitals. Because government health programs and most private insurers now reimburse hospitals for their incurred costs, obsolete facilities all too often remain an indefinite financial burden on the public. The apparently vanquished competitor stays in the field, sustained by cost reimbursement and perhaps providing services that less hard-pressed providers would regard as "unnecessary." Indeed, it is an accepted tenet of planning dogma that excess hospital beds induce inappropriate hospital utilization, because hospitals encourage admissions and longer stays in their effort to remain viable. This belief explains why some planners and regulators have regarded competition from HMOs—as well as other competition that reduces costs by emptying existing hospital beds—as a burden rather than a benefit to the community. In a different way, it also explains why regulation alone cannot extricate us from our predicament: without substantial reform of the financing system, regulation will be overwhelmed by its own contradictions.

Changing Views of Regulation

Disappointment with the small effect that the health planning program—indeed the entire regulatory effort—has had on the growth of health-care spending has prompted some proponents of regulation to call for new, tougher, more centralized controls. One of the best examples of such an approach is the Carter administration's much-debated proposal to put a percentage "cap" on annual increases in hospital revenues and an annual dollar "cap" on the capital projects that could be granted certificates-of-need. The effect of that scheme would be to shift the distasteful burden of rationing resources from the faltering planners and regulators to the providers themselves—who would have to decide how to employ the more limited resources placed at their disposal. While that might not be an inherently bad idea, it would obviously be difficult to establish limits that were inflexible enough to stick, low enough to pinch, but not so low and inflexible as to produce gross inequities among hospitals and regions with different characteristics. Moreover, it has never been established that providers' methods of rationing under such resource constraints would be reliable and free from abuse. Nonmedical considerations—for example, the position of one's physician in the hospital pecking order—may have a significant effect on who gets access to an artificially scarce supply of resources.

[Carter's hospital cost-containment proposal] may have marked a turning point in the health policy debate, since there can be no doubt that Congress, not pleased with what it saw, began casting about for nonregulatory alternatives.

The Carter administration's willingness to embrace such arbitrary forms of regulation amounts to a confession that earlier regulatory efforts have failed. But Congress, which had gone along with those earlier efforts in part because they were flexible and sensitive to local needs, was unwilling to embrace the administration's "cost-containment" proposal. Indeed, by affording Congress a vision of the future under regulation, that proposal may have marked a turning point in the health policy debate, since there can be no doubt that Congress, not pleased with what it saw, began casting about for nonregulatory alternatives.

When confronted with the original control proposal, the Ninety-fifth Congress collectively blanched and then temporized by inviting doctors, hospitals, and insurers to discipline themselves. In the current Ninety-sixth Congress, the House of Representatives has decisively rejected a scaled-down proposal featuring a standby hospital-revenue cap to be imposed if the industry's cost-control program, the Voluntary Effort, fails. (The capital expenditure cap was separated from the revenue cap in the 1979 proposal and is now part of the administration's national health insurance bill.) Of course, the proposal might still be resurrected as part of an emergency response to the soaring inflation that has gripped the nation in 1980. But even if it is ultimately enacted, it seems likely that it will be viewed only as a stopgap measure, increasing rather than decreasing the urgency of implementing alternative, less heavy-handed strategies.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Emergence of the Competitive Strategy

As discouragement has deepened about the prospect for regulation that is evenhanded, flexible, and effective in holding down costs, there has been increased interest in ways to restore meaningful price competition to the health services and insurance markets. The status quo—with neither regulation nor competition enforcing adequate cost-consciousness—is widely considered to be untenable. In this view, the Voluntary Effort is a temporary palliative at best, because it does little, if anything, to redress the distortions in the underlying economic incentives of patients and physicians. In fact, that program is seen as only a reflection of the industry's current need to appear socially responsible enough to be left alone by Congress.

One likely component of any program for promoting competition is substantially in place. The U.S. Department of Justice, the Federal Trade Commission, and some state attorneys general are actively enforcing the antitrust laws against private restraints of trade in the health-care sector. Begun after a 1975 Supreme Court decision that the "learned" professions are subject to the antitrust laws, the antitrust enforcement effort, supplemented by private antitrust litigation and academic research, is revealing how important such restraints of trade have been in shaping the dysfunctional financing and delivery system. Physicians, it seems, have often acted in concert to prevent insurers and others from pursuing the consumer's interest in efficiency and lower prices. Thus, as antitrust enforcement limits the organized profession's control over the economic structure of the industry, there should be organizational and administrative innovations in the financing and delivery of medical care.

Congress itself is also entertaining measures that could hasten the onset of meaningful competition. Of particular interest are the proposals for altering the tax treatment of employer-paid health benefits, which is perhaps the single most important cause of the erosion of cost-consciousness in the industry. By making health insurance a tax-free fringe benefit for both income tax and social security tax purposes, the law encourages consumers to pay small as well as large medical bills through demand-distorting insurance instead of out-of-pocket. Providers of care are to that additional extent relieved of the need to weigh costs against possible benefits. Moreover, because the tax law converts into taxable income any saving in employer-paid premiums that is paid out instead as wages, employees and employee unions have only a diluted incentive to choose low-cost plans. As a result, insurers have only a diluted incentive to challenge organized medicine's preferences. Insurers therefore leave unexplored many possibilities for using their bargaining power and expertise on behalf of their subscribers.

Several bills now under consideration in Congress—for example, Representative Al Ullman's H.R. 5740 and Senator David Durenberger's S. 1590—would decrease the demand for insurance and increase the demand for insurer-initiated cost control by limiting the amount of employer-paid premiums that may be excluded from income. Some of these bills would also require employers to offer their employees a choice of several different health plans and to make an equal contribution to all plans, with employees benefiting directly from choosing a lower-cost option. The hope that significant improvements in the industry's use of resources would ensue seems not entirely misplaced and certainly seems better supported by logic and experience than the hope that regulation will soon improve the industry's performance.

The 1979 Health Planning Amendments

The most concrete sign of Congress's new interest in rejuvenating the market is found, however, in the 1979 health planning amendments. These amendments establish the strengthening of competitive forces as a new "national health priority," introduce legislative findings of fact concerning competition's past and future role, give health planners a new responsibility for fostering competition, and establish new decision-making criteria calling attention to competition's potential for allocating resources without the assistance of regulators. Though not a ringing endorsement of competition under all circumstances, the amendments substantially alter the concept of regulation embodied in the planning act. All things considered, Congress has made it about as clear as it could, short of immediate deregulation, that it

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

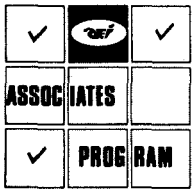
These people say our problems can be solved

Everytime you pick up the newspaper it seems there is another crisis. And it seems like someone is saying it can't be solved. But there are solutions. Some of them have been proposed by the experts and scholars listed here.

They have done so under the auspices of the American Enterprise Institute for Public Policy Research. Founded in 1943, AEI has been called "the liveliest think tank in this town" by columnist Nick Thimmesch and ". . . an increasingly influential center for serious academic study" by **BUSINESS WEEK.**

If you need to see the positive side of dealing with our problems, to be more fully aware of the current issues, you need to receive the AEI publications on a monthly basis.

Check the advantages of the AEI Associates Program and enroll today.



ARTHUR BURNS
IRVING KRISTOL
DANIEL PATRICK MOYNIHAN
NATHAN GLAZER
GEORGE WILL
JACK KEMP
GERALD FORD
PAT SCHROEDER
JESSE JACKSON
JEANE J. KIRKPATRICK
EDWARD KENNEDY
MURRAY WEIDENBAUM
ALFRED KAHN
BARRY GOLDWATER

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

MAXWELL TAYLOR
HERBERT STEIN
DANIEL YANKELOVICH
ROBERT BORK
MICHAEL NOVAK
ROBERT NISBET
BEN WATTENBERG
SAM NUNN

Become an AEI Associate

☑ **Public Opinion**
As an AEI Associate, you receive a one-year subscription to this lively, topical magazine that features articles exploring the reasoning behind the public's opinion combined with a special 20-page roundup of current opinion data from major polling organizations.

☑☑ **TWO MORE ONE-YEAR SUBSCRIPTIONS OF YOUR CHOICE**

Regulation
A popular bimonthly magazine that keeps an eye on government regulation and how it is affecting your daily life.

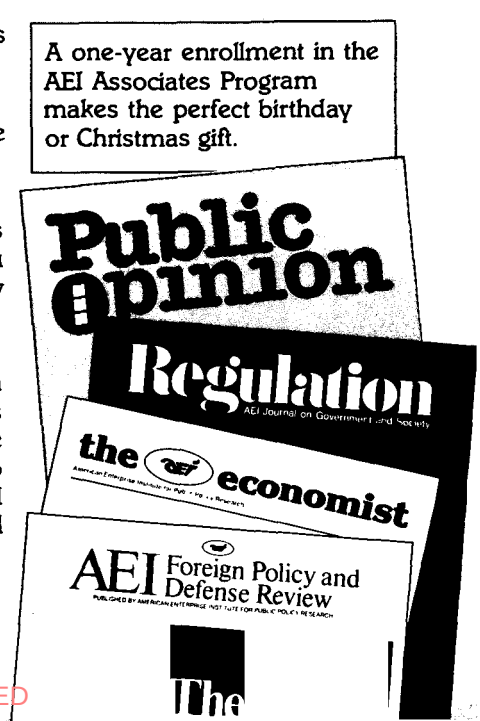
The AEI Economist
An essential monthly report edited by AEI senior fellow Herbert Stein that clarifies current economic issues in an objective manner.

AEI Foreign Policy and Defense Review
Published six times a year, each issue focuses on one foreign policy or defense issue by drawing on the views of internationally recognized experts.

☑ **30% Discount**
In addition, Associates are entitled to a 30% discount on any AEI books or studies you may order during the year. A catalog of the AEI publications is sent to you immediately, and you will be informed of new AEI books through our bimonthly newsletter **MEMORANDUM**.

☑ **Start the advantage today . . .**
To enroll in the AEI Associates Program, or to give the year-long advantage to a friend or relative, just complete the business reply card in the back of this magazine or send $30 to AEI ASSOCIATES PROGRAM, American Enterprise Institute, 1150 Seventeenth Street, N.W., Washington, D.C. 20036. Be sure to print your name and address clearly and note which two of the three AEI periodicals you would like to receive in addition to **PUBLIC OPINION**. (One-third of the enrollment fee will be credited for each periodical subscription.)

A one-year enrollment in the AEI Associates Program makes the perfect birthday or Christmas gift.



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

is no longer wedded to the conclusion that health planning-cum-regulation is an entirely adequate mechanism of social control. Planning and regulation are now viewed as imperfect, though sometimes necessary, substitutes for market forces.

. . . Congress has made it about as clear as it could, short of immediate deregulation, that it is no longer wedded to the conclusion that health planning-cum-regulation is an entirely adequate mechanism of social control.

The essence of the new approach to regulation is captured in some specific findings concerning competition that were added to the law. After stating that "the effect of competition on . . . the supply of health services is diminished," Congress identifies as the "primary source" of the problem "the *prevailing* methods of paying for health services by public and private health insurers" (emphasis added). Congress then directs planners and regulators to measure the need for intervention according to whether the service in question is one "for which competition does not *or will not* appropriately allocate supply. . . ." (emphasis added). Where competition can appropriately allocate supply, planners and regulators are to "give priority . . . to actions which would strengthen the effect of competition . . ."; where it "does not or will not" allocate supply, they are to allocate supply themselves. The clear message is that some services do not need regulation and that the need for regulation of any given service may change over time as the "prevailing" methods of financing change. Indeed, an explicit finding of a market failure would now seem to be a necessary predicate to regulatory action.

It bears emphasis that this new, more skeptical approach to regulation applies even to institutional health services—the services that regulators often argue most need their attention. Although the revised law cites institutional health services as an example of services that are now appropriately regulated, a careful reading of the full statute and the pertinent legislative history establishes that the possibility of freer entry is contemplated even here. For example, the House Commerce Committee states in its report on the amendments that planners and regulators who are considering an institution's application for a certificate-of-need should consider whether "an innovative financing, reimbursement or service delivery arrangement . . . will . . . properly allocate the supply of those services."

Health Planning after the 1979 Amendments

The 1979 planning amendments do not tell planners and regulators how to decide when the market works well enough to supplant regulation, but leaves them considerable leeway in this regard. The forthcoming interpretive regulations of the Department of Health and Human Services might provide some guidance, but that department's record of hostility to the market and its usual preoccupation with stopgap cost-control measures and disinterest in more fundamental change cast doubt on its willingness to take the new mandate seriously.

Some factors that should influence the ultimate judgment about the appropriate role for competition are readily apparent. Among them are the scope of insurance coverage for a service, whether the demand for the service is significantly and inappropriately increased by that coverage, whether insurers have instituted cost controls to offset the demand-distorting effects of their coverage, and whether consumers' price sensitivity and providers' risks from the creation of excess capacity are in fact undercut by the prevailing methods of setting premiums, paying benefits, and reimbursing providers. In keeping with the amendments' emphasis on the financing system's potential for change, planners and regulators should also weigh the amenability of the service in question to as yet untried forms of private cost control. If the threat of higher costs could reasonably be expected to stimulate private insurers to take protective action against the proliferation of expensive, overutilized services, that threat could be viewed as a desirable stimulus to insurer innovation and the emergence of market forces. Thus, the planners and regulators of a market might announce that at some set date they will cease restricting new investments in a particular service, leaving insurers to control

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

costs for themselves. In short, planners and regulators could adopt a "market-forcing" strategy. The resulting insurer innovation would strengthen the market pressures bearing on both the providers of the service in question and on other insurers, who would also have to take steps to address the cost problem. Even the public financing programs could be regarded as capable of doing more to protect themselves against rising costs.

If one has an idealized view of government's efficacy, regulation will inevitably seem superior to the flawed marketplace, and any departure from the textbook model of competition—such as consumer ignorance about medicine—will appear to justify intervention. As described earlier, however, regulation's supposed strengths often disappear in the face of practical difficulties. Thus, if regulators could be persuaded to make a realistic assessment of the comparative advantages of an imperfect marketplace and imperfect regulation, they might defer to market forces more often. An agency might also forgo command-and-control regulation simply because it had better things to do with its limited resources. Even the HSA that thought it might increase efficiency in the short run by limiting entry might, for example, conclude that its limited resources would be better spent on other activities with more substantial long-run benefits—perhaps encouraging local employers, insurers, and providers to participate in restructuring the financing and delivery system so as to reduce the need for regulatory controls.

Successful implementation of the new planning amendments requires that regulators be creative and farsighted and that they commit themselves to the policies of the act, even at the expense of their own bureaucratic interests or the interests of specific providers. That, of course, is a very tall order—so tall, in fact, that only a little inbred cynicism or a minimal knowledge of past regulatory behavior could lead one to conclude that it cannot be filled.

It would be a mistake, however, to assume too casually that resistance by planners and regulators will completely undermine the intent of the amendments. Would-be entrants into a market will soon learn to frame their proposals in terms that require planners and regulators to make reasoned findings on com-

I'M SICK, ALL RIGHT...YEAH!
-SICK OF YOU DIM-WITTED, IDIOTIC, PEA-BRAINED POLITICIANS... SICK OF YOUR USELESS PROGRAMS... SICK OF PAYING YOUR BILLS!
Ted
NATIONAL HEALTH

Reprinted by permission of the Chicago *Tribune*-New York *News* Syndicate.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

petitive impact. In addition, the courts should force the agencies to be explicit on such matters and to have substantial evidence to support their views. Most important, however, some—perhaps a significant minority—of the planners and regulators in the nation's 200-plus HSAs and more than fifty certificate-of-need agencies will recognize competition as useful in achieving their goals. Out of the creative efforts of this minority might come not only opportunities for new, efficient ways of organizing and paying for health services, but also renewed faith in the market as an institution. This, in turn, might well transform the entire regulatory climate. The decentralized nature of the planning apparatus might therefore foster a change in regulatory practice that could never occur in a single monolithic agency belatedly assigned the task of promoting competition.

It is also important to note that Congress recognized that giving regulators a statutory directive to weigh competition might not be sufficient to guarantee that competition would be accorded its due. To complement that directive, Congress exempted HMOs almost entirely from regulation on the ground that they are sufficiently disciplined by market competition that they should not be second-guessed by planners and regulators—a logical application of the basic principle that regulation is appropriate only where there is an identifiable market failure. Since the exemption from regulation itself encourages the development of more cost-sensitive plans, competitive pressures can be expected to intensify and ultimately to affect the behavior of traditional insurers and fee-for-service providers. If that occurs, competition will have obviated the need for most restrictions on new capital investment and new market entry.

Conclusion

Twice-cursed, health planning and certificate-of-need regulation as envisioned in 1974 were doomed. Like the "old" economic regulation, they were subject to being used for protectionist ends. And like the "new" health and safety regulation, they were subject to a lifesaving imperative that made explicit trade-offs between health and economic considerations a near impossibility. Under the circumstances, it was wishful thinking to expect that the public's interest in a more efficient health-care system would be well served.

Some, or even most, devotees of the free market will argue that it is similarly naive to hope that significant deregulation can spring from this same regulatory process. Their skepticism may be well-founded. Yet there should be no illusion that a rejection of this approach to deregulation will speed the outright repeal of regulation. Because regulation has such deep roots in the health-care industry, any judgment that competition cannot survive in a regulated climate is more likely to cause policy makers to abandon competition than to abandon regulation. Even if it might be the best strategy, immediate and complete deregulation is not in the political cards at the moment.

Because regulation has such deep roots in the health-care industry, any judgment that competition cannot survive in a regulated climate is more likely to cause policy makers to abandon competition than to abandon regulation.

Through the 1979 health planning amendments, Congress has at least reopened the overriding question—should market competition be the preferred mechanism of social control in this industry? The result could be to allow enough play in the joints of the planning and regulatory apparatus to give competition the opportunity it deserves to prove itself in practice. ■

Selected References

Clark C. Havighurst, "The Prospects for Competition under Health Planning-cum-Regulation," in Mark V. Pauly, ed., *National Health Insurance: What Now, What Later, What Never?* (Washington, D.C.: American Enterprise Institute, forthcoming).

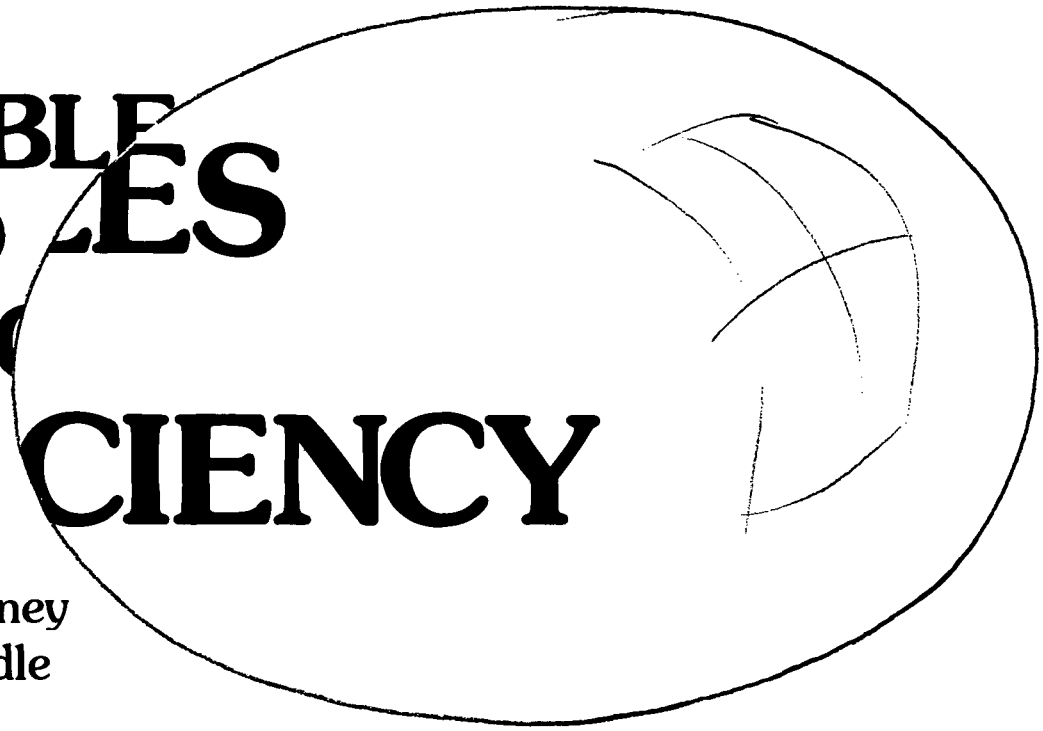
Frank A. Sloan and Bruce Steinwald, "Effects of Regulation on Hospital Costs and Input Use," *Journal of Law and Economics*, vol. 23 (April 1980), pp. 81-109.

U.S. Congress, House of Representatives, Committee on Interstate and Foreign Commerce, *Health Planning and Resources Development Amendments of 1979*, H. Rept. 96-190 to accompany H.R. 3917, 96th Congress, 1st session, 1979.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Cleaner Air at Lower Cost

BUBBLES AND EFFICIENCY



M. T. Maloney
Bruce Yandle

THE REGULATION of air pollution has followed a perplexing path. Theorists have long urged the Environmental Protection Agency (EPA) to adopt principles that would lead to the most efficient ways of achieving cleaner air. The regulators, however, have insisted upon a seemingly more straightforward scheme: if the goal is to improve air quality by, say, 10 percent, the obvious thing to do is to require the use of pollution controls that reduce emissions at each and every source by 10 percent. This approach has formed the basis for national air quality policy for almost a decade. Thus, in accordance with the mandate of the Clean Air Act of 1970, EPA established national standards for six pollutants and required the states to impose so-called technology-based standards to be met uniformly at every smokestack or other emission source, no matter how many of these sources a given facility had.

Finally, EPA came to recognize the inefficiency of the source-standards approach. In December 1979, one year after endorsing an experimental "bubble" policy (see "Blowing Bubbles at EPA," *Regulation*, March/April 1979), the agency announced two new options for reducing air pollution. For a particular pollutant, (1) the agency will focus on an entire plant—rather than individual sources in the plant—and allow management to meet an overall plant standard in any way it might choose, or (2) the agency will consider a regional grouping of plants and develop a process whereby these plants adjust their emissions so as to achieve the regional goal. In either case, according to the final rule issued by EPA on December 11, 1979:

> Sources will have the opportunity to come forward with alternative abatement strategies that would result in the same air quality impact but at less expense by placing relatively more control on emission points with a low marginal cost of control and less on emission points with a high cost. (44 *Federal Register* 71781)

EPA's new cost-effectiveness or "bubble" approach is simple enough to understand when applied to a single plant. If the cost of removing an additional unit of a given pollutant (the incremental or marginal cost) is higher for some sources than for others, the manager can reduce the plant's total cost of achieving the desired air quality by shifting emission control

Mike Maloney and Bruce Yandle are, respectively, associate professor of economics and professor of economics at Clemson University.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

from the higher-cost to the lower-cost sources until the point is reached at which incremental cost becomes the same at each source. At that point, the total cost of meeting the plant standard is minimized. The practical problems are a bit more complex when this approach is applied to a collection of plants, but the principle is the same. The plant manager whose incremental costs of emission reduction are high will look for opportunities to realize savings by paying neighbors whose costs are low to cut their emissions by the needed amounts.

Given that the theoretical case for the cost-effective bubble approach is simple and compelling, why did EPA take so long? There are many reasons, no doubt—including bureaucratic caution, uncertainty about the monitoring technology that would be needed to police the system and, perhaps most important, the fact that the theory was not solidly buttressed by cost estimates of alternative emission control situations. In the absence of such estimates, decision makers were left to wonder about the extent to which incremental cost really mattered. Were the savings to be gained significant? Were they large enough to offset the possibly higher monitoring costs that might be involved?

The Du Pont and Maloney-Yandle Studies

In the summer of 1979, we carried out a research project that bears upon these questions. The raw material for our work came from a study conducted in 1976 by T. A. Kittleman and R. B. Akell, two engineers of the E. I. du Pont Company, in which they estimated the costs of achieving an 85 percent reduction in hydrocarbon emissions at each source in all of the Du Pont plants within the United States. From their investigation, Kittleman and Akell learned that the differences in average reduction costs among sources were monumental. In short, they found significant economies of scale in the control of hydrocarbon emissions—which is to say, the cost of reducing an additional unit of emissions from a large source (one emitting a large volume of hydrocarbons) was lower than for a small source. Kittleman and Akell did not determine the incremental cost of control on a source-by-source basis, and therefore could not compare the costs of alternative approaches for reducing hydrocarbon emissions. That is what we set out to do.

Du Pont provided us with its data base and support for our investigation. Our objective was to develop a procedure for calculating costs at different levels of control, so as to be able to estimate the cost of achieving a given reduction in hydrocarbon emissions under three different regulatory approaches. They were defined as follows:

Source-by-source standards—in which emissions from each source of a given size (defined as sources emitting more than three pounds an hour or fifteen pounds a day) are reduced 85 percent.

Plant-by-plant standards—in which each plant reduces its overall emission level by 85 percent, with managements being free to determine the degree of reduction at each source.

Multi-plant standards (trade-offs among plants)—in which total emissions in a hypothetical region (composed of all the plants qualifying for our sample) are reduced by 85 percent, with plants being permitted to exchange emission permits.

The first approach is theoretically the most costly, since the percentage reduction is the same at each source, no matter how high or how low the cost of achieving it. Under this approach, cost-effectiveness is swapped for regulatory convenience. The second approach parallels EPA's new plant bubble concept, in which total emissions from a plant are monitored, but variation in percentage reductions from individual sources is permissible. Costs are predicted to be lower here, since emission reduction can be concentrated on sources where it is less costly. Under the third approach, the plant bubble is stretched to cover an entire region and trade-offs are permitted among plants so as to make possible larger reductions in emissions where costs are lower, again within the limitation of the same overall percentage reduction in emissions. From society's standpoint, this approach predictably yields the greatest amount of clean air (emission reduction) at the lowest control cost, since the scope for possible cost-saving adjustments among emission sources is greatest.

In the Du Pont data made available to us there were fifty-two plants having a total of 548 sources of hydrocarbon emissions. The variation in the size of the sources—both within and among plants—suggested significant

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

possibilities for exploiting economies of scale in emission control. In our econometric analysis, first we estimated the relationships between the costs of emission control and the operating characteristics of the control equipment for each of the 548 sources. From this, we estimated the incremental cost of emission control at each source. Next, we minimized the control costs for an 85 percent reduction in overall emissions, using first a plant bubble and then a multi-plant or regional bubble. This gave us estimates for those two approaches, which we compared with the figures for source standards taken directly from the Du Pont study.

Cleaner Air at Lower Costs

The results of our analysis were dramatic enough to startle even the true believers (see table). Under source standards, the annual total cost of an 85 percent reduction in emissions for all fifty-two plants, as shown in Du Pont's data, was $105.7 million. When each plant was placed under a bubble and allowed to adjust emission control among sources within the plant, the annual cost for the same reduction in pollution fell to $42.6 million. In other words, the shift from source to plant standards produced the same amount of clean air at a saving of 60 percent. As would be expected, the savings were greater for some plants than for others—ranging, in fact, from a high of 92 percent to a low of zero. This is explained by the fact that some plants had large emission sources with low incremental control costs, whereas others lacked large sources and other opportunities for cost saving as well.

For the purpose of analyzing trade-offs among plants, we treated all the plants in our sample as if they were located in the same (hypothetical) region. When the fifty-two plants were placed under one so-called regional bubble, annual emission control costs were found to be only $14.6 million, 86 percent lower than the costs imposed by source standards.

EMISSION CONTROL COSTS UNDER THREE APPROACHES

Approach	Millions of 1975 Dollars: Annual cost	Millions of 1975 Dollars: Savings over source standards*
Source standards	105.7	—
Plant standards	42.6	63.1
Multi-plant standards	14.6	91.1

*Assuming 85 percent reduction in hydrocarbons.

When the fifty-two plants were placed under one so-called regional bubble, annual emission control costs were found to be . . . 86 percent lower than the costs imposed by source standards.

Taking the regional bubble concept one step further, we estimated the costs that would be associated with hydrocarbon reduction standards higher than the 85 percent assumed above. Here we learned that overall emissions of the plants in question could be reduced by 99 percent at an annual cost of $92.4 million. In other words, the regional bubble yielded significantly more clean air than source standards and still generated cost savings of considerable size.

Some Final Thoughts

Despite the dramatic savings reported here, one should be cautious about lambasting EPA for not having moved years ago toward cost-effective pollution control. Clearly it would not be in the interests of either the polluters or those demanding environmental quality for regulators to rush into schemes whose advantages have not been demonstrated. In the case of the bubble, there were—until quite recently—too many uncertainties. Evidence to indicate the magnitude of the potential savings was largely a matter of conjecture. Moreover, monitoring difficulties, an issue stressed repeatedly by opponents of plant and regional standards, threatened to be a real problem. Whereas technology-based standards have avoided this problem (because they mandate the use of equipment that achieves the required degree of control), under the bubble the emissions themselves become the target and therefore a reliable monitoring capability becomes crucial. Indeed, it probably was the practical appeal of technology-based standards, plus ignorance of how costly they would be, that caused the concept of performance standards, which was central to the Clean Air Act of 1967, to be rejected. For the same reasons, the move to technology-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

based standards in the 1970 Clean Air Act was heralded as a major breakthrough in pollution control. After all, if the equipment is in place and working, pollution is being regulated, though probably in a very costly manner.

In the years since 1970, as control technologies have been developed and applied on a fixed percentage-reduction basis, industry, government, and private scholars have generated information about control costs, especially incremental costs. Monitoring techniques have also been improved as experience has brought a better understanding of pollutants and how they move when discharged. This learning process, though slow and haphazard, has ultimately filled much of the knowledge gap and led to a growing recognition of the possibilities for more cost-effective regulation.

Two questions remain to be answered. First, while it is clear from the evidence presented here that the savings from plant and regional bubbles are very large, are these savings large enough—in all situations, or some—to offset additional monitoring and administrative costs and still generate net social benefits? What is mostly needed here are specific cost data on the monitoring task. Second, will EPA pursue the new regulatory approaches suggested by the accumulating evidence—will it, in other words, facilitate the development of an emerging market in emission rights—or will it stand in the way? In this connection, the agency's first action on a petition from a state for bubble-approving authority presents cause for concern. On March 11 the EPA rejected New Jersey's request that authority to approve plant bubbles be included in its state implementation plan. Given the nation's urgent need to lower the cost of cleaner air, it is to be hoped that the bubble is an idea that cannot be denied much longer. ■

Selected References

T. A. Kittleman and R. B. Akell, "The Cost of Controlling Organic Emissions," *Chemical Engineering Progress,* April 1978.

M. T. Maloney and Bruce Yandle, "The Estimated Cost of Air Pollution Control under Various Regulatory Approaches," a report to the Du Pont Company from the Department of Economics, Clemson University, July 1979.

Bruce Yandle, "The Emerging Market in Air Pollution Rights," *Regulation,* vol. 2, no. 4 (July/August 1978).

Diesel Automobiles

(*Continued from page 14*)

Apart from the question of how diesel particulate-reductions are to be achieved, there is the even more basic question of whether, and to what extent, such reductions are medically, rather than merely aesthetically, desirable. The actual health effects of the diesel are by no means clear. EPA's "White Paper" states:

> Extensive research into the health effects [of chemical substances absorbed by diesel particulates] is underway. Many undoubtedly are toxic. Others, such as polynuclear aromatic hydrocarbons, are known to cause cancer in animals and produce mutations in bacteria. Although it is too early to draw definite conclusions . . ., available data suggests that serious concern is warranted.

The automobile industry, on the other hand, points out that work-place exposure studies have failed to find significant negative long-term health effects, even though diesels have been in use for a long time.

In light of the possible health risks, one is inclined to be more sympathetic to EPA's stringent position on permissible overall particulate levels than to its reticence in adopting fleet averaging to achieve those levels. The averaging approach is demonstrably more efficient and has been applied effectively in other regulatory fields. Of EPA's reasons for further study, one suspects that the reason carrying the heaviest weight is the political difficulty of determining what method of averaging to employ, given the widely varying effects of different methods upon particular firms. Yet surely a flat emission level, as contrasted with any of the various averaging approaches, also has a differential effect. That is to say, some companies will be more affected than others by a uniform limit applicable to all diesel vehicles—so evenhandedness is hardly a rational justification for that approach. At most, one can say that the force of established regulatory habit makes the across-the-board limit *appear* less preferential, or makes EPA *appear* to be avoiding the inevitable preferential choice. On an issue that bears appreciably upon our major problems of inflation and energy, concern with appearances is a luxury we can ill afford.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Readings
of particular interest

Justifying the Expense

Vehicle Safety Inspection Systems: How Effective? by W. Mark Crain (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1980), 70 pp.

In this study, economist W. Mark Crain examines the effects of the federally mandated vehicle-safety inspection programs now administered by more than half the states. He finds that they make no detectable contribution to improving highway safety and, indeed, may even contribute to accidents by making drivers overconfident. Yet, in spite of this report card and the enormous costs associated with these programs, the pressure is growing in Congress to expand their scope to include control of automobile emissions and gasoline consumption.

The author, an associate professor at Virginia Polytechnic Institute and State University, estimates the annual costs of safety inspections at $200 million in fees, $2–7 billion in unneeded repairs, $300 million in lost time to vehicle owners, and $200 million in resources diverted to obtaining inspection licenses.

He traces the history of vehicle safety inspection from its beginning in 1926 as a voluntary Massachusetts program through the passage in 1966 of the two laws that support current federal involvement, the Highway Safety Act and the National Traffic and Motor Vehicle Safety Act. The Highway Safety Act mandated uniform nationwide safety standards for state-administered vehicle registration, operation, and inspection; any noncomplying state risks the cutoff of federal highway aid. The Motor Vehicle Safety Act required that standards for "vehicles in use" be issued by 1968 but it was not until September 1973, after being so ordered by the U.S. district court, that the National Highway and Traffic Safety Administration issued the required standards.

Twenty-seven states and the District of Columbia currently have some form of mandatory vehicle inspection affecting approximately 76 million vehicles a year. Through the years, legislation has given NHTSA more discretion in its annual approval of state safety programs, and states have been given more leeway to tailor their programs to specific needs. And this, in Crain's judgment, "makes even more relevant the question of the merits of periodic inspection programs."

The author finds five unresolved issues in the present situation: First, even if vehicle inspection improves safety, its effect may be dissipated if drivers take more risks than they would if their cars were not periodically inspected, or if they assume that inspection will take care of mechanical defects. Second, even if voluntary behavior produces "suboptimal investment" in vehicle maintenance, it is not obvious that vehicle inspection is a feasible means of detecting equipment problems. Furthermore, even if it were, it is not clear that inspection agents have sufficient incentives to perform well. In addition, even if vehicle inspection does lead to corrections in mechanical problems, the programs may not be a cost-effective means of improving highway safety. Finally, the extent to which individuals accurately evaluate the expected costs of highway accidents is not known; thus it is not clear that drivers do underinvest in vehicle safety maintenance in the absence of periodic inspections.

An empirical analysis of the relationships between several alternative systems of vehicle inspection and highway safety leads Crain to a number of conclusions: (1) mandatory periodic inspection programs do not appear to reduce accidents; (2) twice-yearly inspections are no more effective than yearly inspections in reducing highway accidents; (3) state owned and operated inspection stations are no more effective than private inspectors in reducing accidents; and (4) spot or random checks appear

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to reduce death and nonfatal accident rates, at least as effectively as periodic checks. In the author's opinion, this last point argues for the sanctioning of random inspection to replace periodic inspection on a permanent basis.

Who, then, benefits from periodic safety inspection programs, if not the motorist or the potential accident victim? The author cites various "special interest groups" and "numerous trade associations involved in inspection-related activities"—for example, service stations and windshield-wiper manufacturers. Such interests, he notes, are now exerting pressure to establish even more stringent standards and to expand the scope of inspections to include emission controls and mandatory tuneups. They also would prefer direct administration by the federal government. Crain finds it "ironic that a program with no demonstrated effectiveness is being expanded to encompass additional aspects of motor vehicle operation."

Age as a Blunt Instrument

"The Graying of Civil Rights Law: The Age Discrimination Act of 1975" by Peter H. Schuck, in *Yale Law Journal*, vol. 89 (November 1979), pp. 27-93.

In this article, Peter H. Schuck of the Yale Law School contends that the Age Discrimination Act of 1975 constitutes a highly flawed policy instrument—one that reflects many of the tensions arising from efforts to use nondiscrimination laws to attack conditions that are not rooted primarily in bias or enmity. Schuck takes the position that Congress, in passing this law, abdicated its policy-making responsibilities to the courts, which are poorly equipped to perform them. He suggests a conceptual and legal approach to age discrimination for guiding the courts in their implementation of the law.

The Age Discrimination Act was modeled directly on Title VI of the Civil Rights Act of 1964, which prohibited discrimination on the basis of race, color, or national origin in the vast range of federally assisted activities. Yet the analogy between age and race discrimination, Schuck argues, is crude and misleading. First, decision makers do not use age and race to distinguish among people in the same ways. For example, age is often used as a proxy for other characteristics, such as maturity, the likelihood of possessing certain risk factors, or expected duration of future employability. This may lead to injustice in particular cases because of under- or over-inclusiveness of categories; yet countervailing equitable or administrative considerations, such as the cost of attempting to measure such characteristics directly, may argue strongly for using the proxies anyway. Similarly, age is an immanent, inescapable characteristic, and it is easily verified; thus, individuals are less likely to alter their behavior in response to the incentives created by an age rule than they might be in response to a rule based on, say, income. In short, the use of an age criterion to classify people will often be reasonable in circumstances in which the use of a racial criterion would be invidious. By the same token, the consequence of forbidding the use of income, education, and other non-age factors that produce age-specific differentials would be very extreme, because virtually all such factors will produce such differentials.

From this analysis, Schuck concludes (1) that "the use of age as a classificatory criterion entails a far smaller risk of arbitrariness and oppression than the use of race, alienage, or other criteria that have been held to exacting standards by the courts" and (2) that an appropriate definition of age should "necessarily be one of relatively limited reach, leaving decision-makers free to employ age distinctions and non-age criteria in a wide variety of social choice contexts."

The political and legislative setting in which Congress developed the Age Discrimination Act represents a classic instance of procedural and substantive failure in the policy-making process. Added to pending legislation almost as an afterthought, the act sailed through Congress without any real consideration of the necessity or implications of such a sweeping law. When troubling questions about the bill's meaning and consequences were finally raised in conference committee, Congress passed the legislation anyway, requiring only that regulations under the law be deferred until the Civil Rights Commission had conducted a study of age discrimination.

That commission study, Schuck argues, was both conceptually and analytically defective. For example, it employed an absurdly

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

broad definition of age discrimination and uncritically adopted the analogy to race discrimination. As a result, the commission denounced as discriminatory a welter of policies and practices that appear to be bona fide—though often flawed—efforts by decision makers to accommodate policy objectives to limited resources, and it recommended changes in the still unimplemented law that would have prohibited even "reasonable" uses of age. These recommendations were actually approved by the House, but were turned back in conference.

Schuck analyzes the critical legal and policy issues raised by the law. Perhaps the most far-reaching, in his view, is the extent to which decision makers may use cost-benefit judgments in allocating scarce resources among potential program beneficiaries. May medical schools bar applicants in their fifties? May job training programs focus on unemployed teenagers and youths rather than the middle-aged? These difficult decisions will have to be made by the courts with little guidance from Congress or the Department of Health and Human Resources, whose predecessor issued the government-wide implementing regulations.

Structurally, the Age Discrimination Act combines two types of group protection remedies—the "nondiscrimination model" (based on the Title VI analogy) and the "allocative model" (which affords decision makers some leeway in using age criteria to allocate program benefits). While these models are not logically inconsistent, Schuck argues, they have "distinctive tendencies and implications that are at war with one another." They differ in their approach to the notion of legal entitlement; they command decision makers in different ways; they attempt to address a different range of problems and activities; and they pursue redistributive ends in a different manner. Each of the models, Schuck suggests, is appropriate for addressing particular kinds of social problems. By rejecting the kind of refined, targeted, problem-oriented approach to the age discrimination problem that the allocative model would have encouraged, Congress may have created unanticipated difficulties. In particular, it has thrust upon the courts a major role in determining policy under the act, a role that will embroil them in essentially allocative tasks armed only with the crude tools that a nondiscrimination model provides. When this occurs, it will be denounced as "judicial usurpation." But the abject failures of Congress and the executive branch in this matter, Schuck suggests, make one wonder where buckpassing ends and usurpation begins.

Squeezing the Little Guy

Small Business Performance in the Regulated Economy by Kenneth W. Chilton and Murray L. Weidenbaum (St. Louis, Mo.: Center for the Study of American Business, 1980), 43 pp.

"In spite of the widespread concern about the various burdens imposed by government regulation in America today, there seems to be a naive belief . . . that the regulatory system is neutral with respect to the size of the business firm. In reality, a great deal of government regulation has disproportionately adverse effects on smaller businesses." Kenneth W. Chilton and Murray L. Weidenbaum—acting director and director, respectively, of the Center for the Study of American Business at Washington University in St. Louis—document this assertion by examining the effects of federal regulation on small businesses in a wide range of industries and for the gamut of federal requirements, from paperwork to mandated capital expenditures and product bans.

According to the authors, because small businesses rely on relatively more expensive short-term debt, they are particularly vulnerable to the burden of the large capital expenditures imposed by the regulations of such agencies as the Environmental Protection Agency and the Occupational Safety and Health Administration. They point out as well that a small firm does not have the same capability as a large one to pass along the resulting increased production costs to the consumer. That is, the small firm must attempt to spread its compliance costs over a smaller number of units, thus eroding its competitive position vis-à-vis a large firm in the same industry. "In other words," the authors state, "capital expenditures mandated by government regulation produce artificial 'economies of scale.' "

Chilton and Weidenbaum focus on the manufacturing sector because, while it is burdened by government regulation in general, it is particularly hard hit by the capital expendi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tures required to comply with federal regulations. In addition to assembling case studies of the effects of regulation on the foundry, battery, trucking, masonry construction, and apparel manufacturing industries, they report the results of their own survey of the chemical specialty and forging industries. There EPA and OSHA rules cause the greatest difficulties for small firms, and the effects can be profound:

> Fifteen percent of those firms having difficulty with EPA regulations felt that the agency's regulations could cause the firm to close for an unspecified duration. In addition, nearly 12 percent of the small chemical specialty manufacturers felt that EPA regulations could cause a change in ownership of their firm. Twenty-two percent of the forging firms felt that OSHA could cause such a closing and 17 percent felt that EPA could have a similar effect.

Turning to the so-called paperwork burden, the authors point out that, although there have been various attempts to quantify the costs of federal paperwork requirements, the effect of these requirements appears to be essentially qualitative. "The very notion of paperwork is anathema to many small business people," they observe.

Various regulatory reforms have been proposed to alleviate the disproportionate impacts of regulation on small business: exemption from minor paperwork requirements, two-tiered regulations for small and large firms, small business impact statements, and even total exemption of small firms from some forms of regulation. Interestingly, according to the authors' survey, small businesses find general regulatory reform preferable to remedies designed specifically for them.

Therefore, the authors encourage regulators to consider innovative approaches, such as requiring the dissemination of information on comparative product safety instead of mandating safety standards, or emphasizing performance incentives instead of standards and compliance enforcement. "The simplest reform measure," they argue, "would be for the regulatory agencies to weigh carefully the effects of their activities on business in general and small business in particular, prior to final rule setting." This approach would require a changed attitude on the part of those many regulators who currently see small business as "an unfortunate but necessary casualty of their mission to serve 'the public interest.' "

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Toward a Value for Human Life

Reducing Risks to Life: Measurement of the Benefits by Martin J. Bailey (Washington, D.C.: American Enterprise Institute, 1980), 66 pp.

Can an economic value be placed on human life? Economist Martin Bailey of the University of Maryland confronts this issue directly and asserts at the outset that "whether we do so directly or by implication," we do indeed "place a value on human life." But what is that value and how should it be determined?

Economists have offered various approaches, including analysis of how much people pay for accidental death or injury insurance, and what they can be expected to contribute to society over their lifetimes as measured by real income (that is, the discounted value of future earnings). Bailey rejects both of these approaches and instead concentrates on workers' "willingness-to-pay" for safety as revealed by their employment decisions.

As the author sees it, "The most direct evidence of the amount people are willing to pay for their own safety comes from the job market, which offers a variety of working environments with various degrees of personal risk." Simply put, workers demand and receive higher wages for riskier jobs. And the wage "premium" accepted for an increased risk of death or injury reveals implicit assumptions about the value workers place on their lives.

Bailey analyzes four economic studies of occupational wage differences resulting from risk differentials and one study of "willingness-to-pay" for safety based on data from seat-belt usage. Two of the wage-risk differential studies, one by Richard Thaler and Sherwin Rosen for the National Bureau of Economic Research in 1976 and the other by Alan Dillingham in his 1979 Ph.D. dissertation, are adjusted by Bailey to allocate wage premiums between risk of death and risk of injury, to reflect the fact that low-income workers accept smaller premiums than high-income workers, and to account for third party contributions such as employers' worker compensation premiums and indirect business taxes. The seat-belt study, a 1979 Ph.D. dissertation by Glenn Blomquist, is adjusted to include indirect business taxes and third party medical and insurance payments. These three studies, when also adjusted for inflation, produce "value of life" estimates ranging from $170,000 to $715,000 per life—which figures are judged "reasonable" by the author.

The two wage studies by Robert Smith and W. Kip Viscusi provide estimates of the value of a life that are much higher than the other three estimates—in Viscusi's case ranging as high as $3.25 million per life (current dollars). Results from both of these studies, however, are based on representative samples of workers from various industries and on job-risk statistics calculated from industry averages. In Bailey's view, the difference between the Viscusi/Smith estimates and the other three stems from the broader aggregation levels used by Viscusi and Smith—that is, from the use of data that do not come from specific workers. Bailey feels this makes it difficult to attribute wage levels directly to higher risks as opposed to other factors, such as differing characteristics of workers in the occupation. Viscusi's position on this point is that such studies as those by Thaler-Rosen and Dillingham apply only to self-selected workers who are least averse to risk and who therefore place a low implicit value on life. Conceding this possibility, Bailey says that although his "evidence is internally consistent and gives no indication of worker error in this respect, it is also consistent with systematic worker error in estimating this risk."

The policy implications of choosing the Thaler-Rosen-Dillingham estimates or the Viscusi-Smith estimates or the more arbitrary estimates of government regulators can be significant. In the case of government regulators "there is clear evidence both of inconsistency and of systematic error. . . . The performance of experts gives no basis for confidence that their opinions should supersede the evidence of household and worker behavior in the marketplace." But Bailey points out that the range of values he considers defensible—$170,000 to $715,000 a life—is "scarcely definitive" and that further research might provide even better estimates. The point of this study is to show that estimates can be derived from evidence on household and worker behavior. Once a range for estimates of the economic value of life is agreed upon by policy makers, the nation's resources can be better allocated among various health and safety programs.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A Cost Conscience for Regulated Industries

The Regulatory Process and Labor Earnings, Ronald G. Ehrenberg (New York, N.Y.: Academic Press, Inc., 1979), 204 pp.

Starting from the premise that regulatory commissions should adopt a standard for "just and reasonable" labor cost increases in order to hold down service costs to consumers, Ronald G. Ehrenberg of Cornell University's School of Industrial and Labor Relations formulates a detailed methodology for fashioning such a standard.

In this book Ehrenberg develops a conceptual framework for analyzing the complex relationship between the regulatory process and the pay of workers in regulated industries. Regulation can affect pay levels, he points out, by altering the structure of a labor market or the behavior of participants in that market, by reducing competition in the relevant output market, or by limiting monopoly profits through the setting of maximum prices. In addition, regulation can affect labor earnings by forging incentives for managers of regulated companies to limit increases in labor earnings to rates commensurate with increases received by comparable workers in other industries.

Ehrenberg argues that such limits are the key to restoring the link that existed in the 1960s between profit rates in regulated industries and their ability to restrain service cost increases. He argues that a standard which ascertains what part of labor cost increases should be passed on to consumers in the form of rate or price increases will encourage management to bargain harder with unions since "excessive" pay increases would no longer translate automatically into price increases. The author then illustrates the difficulty of developing and implementing such a standard through a case study of a rate increase filed by New York Telephone Co. (NYT), a subsidiary of AT&T, before the New York State Public Service Commission in November 1976. A significant part of the requested rate increase was earmarked to cover expected wage and fringe benefit increases taking effect the following year.

As a first approximation of the extent to which NYT's labor costs are "just and reasonable," Ehrenberg compares the average earnings of NYT's workers with those of comparable employees in other firms in the same labor markets. Insofar as NYT's average earnings across occupations exceed the "norm" set by other employers in the state, Ehrenberg argues, the differences should be borne by NYT's stockholders in the form of lower profits rather than by consumers in the form of higher utility bills. By analyzing wage data from several different sources, the author produces a range of estimates of the "premium" enjoyed by NYT workers and the cost to consumers if a full pass-through were allowed. One methodological approach applied to census data yields an estimated premium of 15 to 20 percent.

Noting the danger of relying solely on wage-scale or earnings data to make fair comparisons among groups of workers, Ehrenberg turns to a discussion of fringe benefits, productivity, and labor turnover. He points out that when these additional factors are taken into account, a preliminary conclusion that a particular company is a "high-wage" employer could be overturned. In the NYT case study, however, Ehrenberg's estimate of the impact of these nonwage factors tended to shore up rather than undermine his tentative conclusion based on wage data alone.

Although the NYT case study—the backbone of this book—involves state regulation of a public utility, both the methodology developed for establishing cost pass-through standards and the theoretical framework for analyzing the interaction of the wage-setting and regulatory processes are applicable beyond the state and utility contexts.

Ehrenberg argues that state public service commissions are not legally precluded from considering whether utilities' labor-cost increases are "just and reasonable" and, indeed, have an obligation to do so. He also stresses that the regulators must provide incentives for utilities' managements to keep cost increases down. Three ways of doing this are suggested: (1) increasing the competition utilities face wherever feasible, (2) implementing executive incentive compensation schemes, and (3) adopting a form of tax-based incomes policy for regulated industries. The third approach would involve smaller fractional pass-throughs for larger wage increases.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

(Continued from page 4)
to be met in practice. The survival of the marginal cost-pricing principle is probably no more than an indication of the extent to which the majority of professional economists are ignorant of the assumptions required for its validity. How else can one account for the glib advocacy of the principle in a society where the marginal rate of income tax is certainly not zero, where optimum taxes are certainly not imposed on both imports and exports, where external effects in consumption are of the first importance, where uncertainty and expectation play a major role in making life worth living, where . . . ?"

The rule of "price according to marginal cost" simply has no desirable properties in the real world. Hence Shenefield's case against introducing redistributive objectives into product pricing fails, and so his general argument in favor of private over public decisionmaking is unfounded.

Shenefield's second point is that government enterprise entails "the loss of discipline inherent in private competitive markets." Loss of discipline by comparison with what? Were Chrysler and Lockheed paragons of competitive discipline before the federal government intervened to guarantee their operations? Hardly. Is the tariff protection the federal government accords to domestic producers of steel, shoes, textiles, Florida tomatoes, and Idaho sugar beets the cause, instead of the consequence, of competitive failure? Hardly. Have General Motors and Ford been inspired to be less competitive than they would otherwise be by the recent transformation of Chrysler into a public charity case? It strains credulity to think so. Or perhaps Shenefield is again making an implicit comparison between simple theory and complex reality—an implicit comparison between the hypothetical private competitive firm of the textbook and actual public and publicly protected private enterprise. If so, his is a case for a cloud-cuckoo-land that never was and never will be.

Shenefield's final point is that public enterprise too frequently escapes the public accountability that government now imposes, through regulation, on the private firm. On this he is right. TVA had a dismal environmental record, the Postal Service lags on occupational safety, congressional employers are exempt from equal opportunity laws —the list could go on. But if this is the problem, then the solution is to extend the substance of government regulation to public business.

More broadly, Shenefield's case against extending the public's jurisdiction is misplaced. The issue should not be whether the federal government should respond to pleas from failing enterprise for assistance, but how. There is a good case for preventive medicine—for economic planning to help keep the private sector productive and solvent. There is an excellent case for the development of a systematic policy to deal with the threat of large-scale industrial failures, instead of the ad hoc crisis management of policy today. But, whether it is well or poorly done, the public sector's responsibilities will continue to grow. There is no return to laissez faire.

James K. Galbraith,
University of Maryland

JOHN H. SHENEFIELD responds:

Professor James K. Galbraith's agreement with my point about the nonresponsiveness of public enterprises gives away his game. I would paraphrase his lengthy quotation from J. de V. Graaff in this way: "The conditions which have to be met before it is correct [from a welfare standpoint] to submit the resource allocation decisions for a particular industry to the political process are so restrictive that they are unlikely to be met in practice. The survival of the principle that basic decisions on price and output ought to be made through a nonmarket mechanism is no more than an indication of the extent to which some economists are ignorant of the assumptions required for its validity. How else can one account for the glib advocacy of the principle in a society where the dynamics of electoral politics may compel public officials to disregard their own vision of the 'public good' in response to pressures from mass-membership organizations, campaign fund donors, and single-issue spokesmen; where significant decisions are made not by elected officials, but by the bureaucracies of both Congress and the executive branch and by independent agencies; where key decisions are subject to review by judges with lifetime tenure; where much of the media's attention is focused on image and conflict, rather than substance and resolution; where high turnover in the ranks of public decision makers gives rise to a tendency to leave difficult problems to one's successors; where . . . ?"

Thus, one can only say that the rule of "price according to political decision" simply has no desirable properties in the real world—or only does if one's analysis of public sector decision making is itself divorced from reality. Indeed, one has only to look at a centrally planned economy slightly to our south or at the economic productivity of countries that have come under the rule of philosopher-kings (or ayatollahs) to feel more than a little justified in believing that nonmarket pricing has more than its fair share of trouble.

What then? I submit that imperfect as the system of cost and pricing signals may be, the monetary cost of producing the next unit of a commodity and the price that potential customers are willing to pay for it tell us more about the value of that next unit of output than any other system of resource allocation of which I am aware. It is closer to the true measure of societal benefit than the beliefs of a congressional appropriations subcommittee staff director or an executive branch budget officer on what is the appropriate funding level for a public enterprise, and certainly a lot closer than some bureaucrat's perception of what is good for us all.

Finally, Galbraith's rejection of marginal-cost pricing has one important implication: the elimination of competition among providers of goods and services, be those suppliers public enterprises or private ones. For a rejection of marginal-cost pricing implies the existence of cross-subsidies: if price and cost have no relationship, then the production of some commodities will simply be more profitable than the production of others. Competitors, if permitted to exist, will attempt to sell that lower-cost product at a lower price and thus deny the enterprise the revenue needed to cover costs incurred elsewhere. The implication is that steps may be taken to prevent competition, so that the cross-subsidized apple cart is not overturned. One need only recall the "cream-skimmer" cries raised by protected firms in the battle to open entry into the airline, trucking, and communications common-carrier industries to realize the vested interests generated by systems that create, or allegedly create, cross-subsidies. Fortunately, these arguments are now being rejected by Congress and regulatory agencies. In a word, those same public institutions in which Galbraith

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

would place his faith have moved, correctly and decisively, in favor of competitive, cost-based pricing mechanisms.

If "there is no return to laissez faire," it is because that blissful state never existed. Instead, what we are now witnessing is a return to a healthy respect for the market system as an allocator of resources and the realization that public intervention, as a general rule, is not a panacea for all problems.

Campaign Finance

TO THE EDITOR:

Herbert E. Alexander's "Public Financing of Congressional Campaigns" (*Regulation*, January/February), makes an ingenious proposal. Insofar as campaign finance lies at the root of our representation problems, his solution may be the best available. Insofar as improved financing of campaigns affects other aspects of representation—political parties, for example—the benefits of Alexander's plan may be more extensive. But, are problems with congressional campaign financing more than annoying symptoms of major failures elsewhere in our system of representation?

Among the basic failures in representation, to which campaign financing is related chiefly as a symptom, are the following: (1) Congressional districts are now more populous and more diverse economically than were most states when our system was established. (2) Along with that, and partly because of long sessions, members of Congress are remote in both geography and social space from their constituents. (3) Nationally organized special interests are able to communicate their desires to members of Congress more directly, more expeditiously, and more continuously than can less organized constituencies. (4) Communication between Congress and its constituents is primarily via the mass media, which are not responsible in either the legal or the political sense.

Does anyone believe that the best possible method of financing congressional campaigns will alter, substantially, even one of the above? Without altering them all, is it possible to restore our system of representation to a condition of vigor and public esteem?

Ivan W. Parkins,
Central Michigan University

TO THE EDITOR:

. . . Herbert Alexander's idea of floor grants rather than matching funds for candidates is not new. It has been around from the very beginning of discussions on public campaign financing and has been repeatedly rejected as thoroughly impractical. Of the 435 House seats up every two years, only about 100 are ever really in contest. The idea of providing $30,000 or $40,000 of taxpayers' money to each of the other 335 certain winners and 335 certain losers is ludicrous.

His scheme of providing candi date funding through the political parties can only strengthen those parties and make members of Congress more responsive to party direction if the party has authority to arbitrarily give or withhold the funds. But Congress is certainly not going to vote this authority to any party officials, nor should it.

Dr. Alexander is an authority on campaign financing. The works of his institute, the Citizens' Research Foundation, have contributed much to the general understanding of the subject. We all owe him a debt of gratitude. Having said that, I hasten to add that this, his most recent suggestion, defies logic, experience, and the will of the people. He proves Lord Acton's view: "There is no error so monstrous that it fails to find defenders among the ablest of men."

For 200 years we had a system of financing campaigns in the United States that worked, not perfectly but certainly adequately. Then, the reform wave of the 1960s and 1970s brought the idea that the political influence of the richest and strongest and the poorest and weakest could be equalized through public financing of elections and by limiting contributions and expenditures. Make no mistake, this was and continues to be the objective.

Have the reform laws of 1971 and 1974 with their restrictions and partial public financing of presidential campaigns achieved their goals? Certainly not. Nature and the system simply exchanged the big contributor for the big collector; the Supreme Court found half the law to be constitutionally invalid; and political action committees became the vehicles of the hated "special interests."

If anyone really believes that a majority of the public wants taxpayer financing of campaigns, he needs only look to the tax returns for rebuttal. Each year 85 million taxpayers vote on the subject and reject the proposition three to one.

It seems to me that Dr. Alexander and other advocates of campaign reform should stop tinkering with machinery that is not broken. They should admit that the adjustments made in 1971 and 1974 have not improved public confidence in either the process or elected officials. They should urge repeal of the 1974 law entirely and the public financing provisions of the 1971 law.

Congress should stop listening to Common Cause's cry that senators and representatives are bought through campaign contributions. If we can believe what we have read about "Abscam," the only official who turned down the preferred cash was the one who was offered a campaign contribution.

Thomas F. McCoy,
Washington, D.C.

HERBERT ALEXANDER responds:

Congressional public financing is not a panacea, and I did not seek to give that impression in my article. Public funding may not materially affect directly the four points made in Professor Parkins's letter, but it is a logical—and needed—next step in the search for an improved electoral system. Tom McCoy makes a number of points worthy of debate, which I have been carrying on with him for a number of years. I would only suggest that public funding is designed to, and perhaps would help to, increase the number of marginal house seats. McCoy is correct in stating that our present system is not sufficiently competitive, but adoption of public funding would at least have a chance of making it more so. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, established in 1943, is a publicly supported, nonpartisan, research and educational organization. Its purpose is to assist policy makers, scholars, businessmen, the press, and the public by providing objective analysis of national and international issues. Views expressed in the institute's publications are those of the authors and do not necessarily reflect the views of the staff, advisory panels, officers, or trustees of AEI.

Council of Academic Advisers

Paul W. McCracken, *Chairman, Edmund Ezra Day University Professor of Business Administration, University of Michigan*

Robert H. Bork, *Alexander M. Bickel Professor of Public Law, Yale Law School*

Kenneth W. Dam, *Harold J. and Marion F. Green Professor of Law, University of Chicago Law School*

Donald C. Hellmann, *Professor of Political Science and International Studies, University of Washington*

D. Gale Johnson, *Eliakim Hastings Moore Distinguished Service Professor of Economics and Provost, University of Chicago*

Robert A. Nisbet, *Resident Scholar, American Enterprise Institute*

Herbert Stein, *A. Willis Robertson Professor of Economics, University of Virginia*

James Q. Wilson, *Henry Lee Shattuck Professor of Government, Harvard University*

Executive Committee

Richard B. Madden, *Chairman of the Board*
William J. Baroody, Jr., *President*
Richard J. Farrell, *Treasurer*
Charles T. Fisher III
Herman J. Schmidt
Richard D. Wood

Edward Styles, *Director of Publications*

Program Directors

Russell Chapin, *Legislative Analyses*

Robert B. Helms, *Health Policy Studies*

Thomas F. Johnson, *Economic Policy Studies*

Sidney L. Jones, *Seminar Programs*

Marvin H. Kosters/James C. Miller III, *Government Regulation Studies*

W. S. Moore, *Legal Policy Studies*

Rudolph G. Penner, *Tax Policy Studies*

Howard R. Penniman/Austin Ranney, *Political and Social Processes*

Robert J. Pranger, *Foreign and Defense Policy Studies*

Periodicals

AEI ECONOMIST, Herbert Stein, *Editor*

AEI FOREIGN POLICY AND DEFENSE REVIEW, Robert J. Pranger and Donald C. Hellmann, *Co-Editors*

PUBLIC OPINION, Seymour Martin Lipset and Ben J. Wattenberg, *Co-Editors;* David R. Gergen, *Managing Editor*

REGULATION, Antonin Scalia and Murray L. Weidenbaum, *Co-Editors;* Anne Brunsdale, *Managing Editor*

William J. Baroody, Sr., *Counsellor and Chairman, Development Committee*

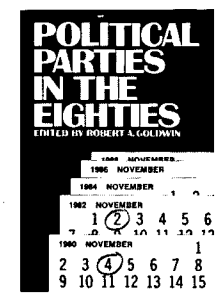
ADVISORY COUNCIL, CENTER FOR THE STUDY OF GOVERNMENT REGULATION

Irving Kristol (chairman), Robert H. Bork, Bill Brock, Ronald H. Coase, Kenneth Dam, John N. Erlenborn, Bryce N. Harlow, Robert H. Hatfield, Ernest F. Hollings, Max M. Kampelman, Lewis Lehrman, Paul W. MacAvoy, Richard Posner, Richardson Preyer, R. Randolph Richardson, William Ruckelshaus, George P. Shultz, Paul Weaver, Murray Weidenbaum, Aaron Wildavsky, and James Q. Wilson. Marvin H. Kosters (director) and James C. Miller III (co-director).

American Enterprise Institute for Public Policy Research
1150 Seventeenth Street, N.W. • Washington, D.C. 20036 • 202/862-5800

MUST READING

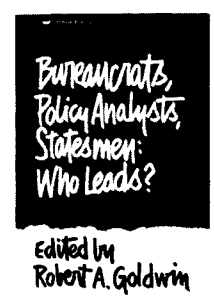
POLITICAL PARTIES IN THE EIGHTIES
edited by Robert A. Goldwin



Provocative essays on party reforms since 1968, what the consequences have been, and what the future is likely to be. The authors — some played leading roles in fashioning the reforms—present sharply opposed views. This is a book full of solid information and sustained political controversy.

cloth $10.25 paper $5.25

BUREAUCRATS, POLICY ANALYSTS, STATESMEN: WHO LEADS?
edited by Robert A. Goldwin



Essays on problems and prospects for leadership in a modern mass democracy. Are bureaucrats and policy analysts indispensable aides in a complex world, or do they ultimately make political leadership impossible? Both views — and many others—are argued forcefully from the vantage points of the academician, policy analyst, journalist, and political appointee in this volume of informative controversy.

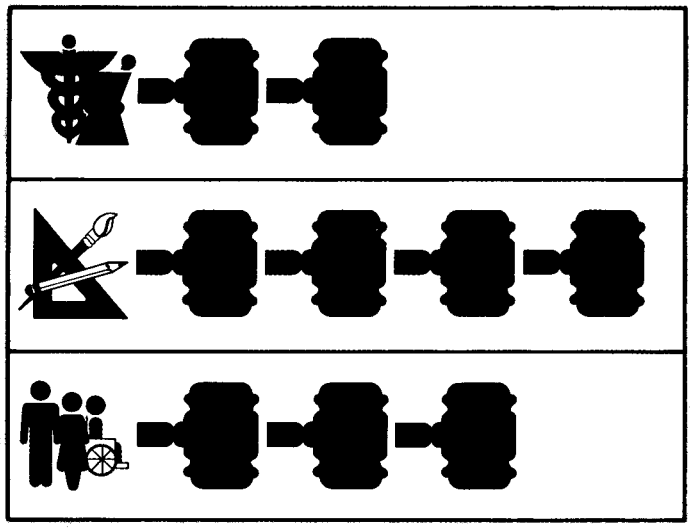
cloth $10.25 paper $5.25

To order call toll free (800) 424-2873 between the hours of 9:00 am and 5:00 pm EST. In the Washington, D.C. area, call (202) 862-5869.

Or write: American Enterprise Institute
Department 285
1150 Seventeenth Street, N.W.
Washington, D.C. 20036

Be sure to include your name and address, the title of the publication and your check made out to American Enterprise Institute.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



From AEI . . .

Recent Studies on Government Regulation

From Drug Laws to Advertising to Social Regulation

Benefit-Cost Analyses of Social Regulation: Case Studies from the Council on Wage and Price Stability

James C. Miller III and Bruce Yandle, eds.

The benefits and costs of various regulatory programs dealing with safety, health, and the environment are studies in essays inspired by the Ford administration's Council on Wage and Price Stability. The essays reflect the view that benefit-cost analysis can be applied to a broad variety of social regulatory programs. The essays also reflect an awareness of the statutory limitations and the political constraints under which programs operate.

"This is a fine selection of applications . . . . A significant contribution to the resolution of important issues of public policy. It deserves a wide public affairs audience." PERSPECTIVE

3334-2 / $6.25

Unsettled Questions on Regulatory Reform

Paul W. MacAvoy, ed.

This volume presents a broad range of views by authorities on government, law, and economics. Participating in the discussion are John W. Barnum, Stephen G. Breyer, Lloyd N. Cutler, Hendrik S. Houthakker, Paul Joskow, Roger G. Noll, Merton J. Peck, Sam Peltzman, Glen O. Robinson, John E. Robson, Antonin Scalia, John W. Snow, and Richard E. Wiley. Paul W. MacAvoy acts as moderator.

3328-8 / $3.25

Welfare Gains from Advertising: The Problem of Regulation

Dean A. Worcester, Jr., with Ronald J. Neese

An examination of the evidence linking advertising to monopoly power shows that estimates of welfare loss attributable to advertising are significantly overstated. Regulation, according to this study, protects not the consumers but rather the existing producers at the expense both of new competitors and of consumers. Worcester explains why the body of economic theory known as welfare economics cannot be applied successfully to public policy and concludes with the development of a theoretical model applicable to normative analysis.

3290-7 / $5.25

Forming Multimodal Transportation Companies: Barriers, Benefits, and Problems

Clinton H. Whitehurst, Jr., ed.

Should multimodal transportation companies be allowed to be formed without restriction on the modes included? Background papers by Rodney E. Eyster, Paul O. Roberts, and Harvey M. Romoff consider the history of federal regulation of and policy on multimodal ownership, the economic conditions necessary for successful multimodal operations, and the multimodal transportation companies of Canada.

"Useful background articles by noted scholars." LIBRARY JOURNAL

2146-8 / $6.25 **2147-6 / Cloth $12.25**

Issues in Advertising: The Economics of Persuasion

David G. Tuerck, ed.

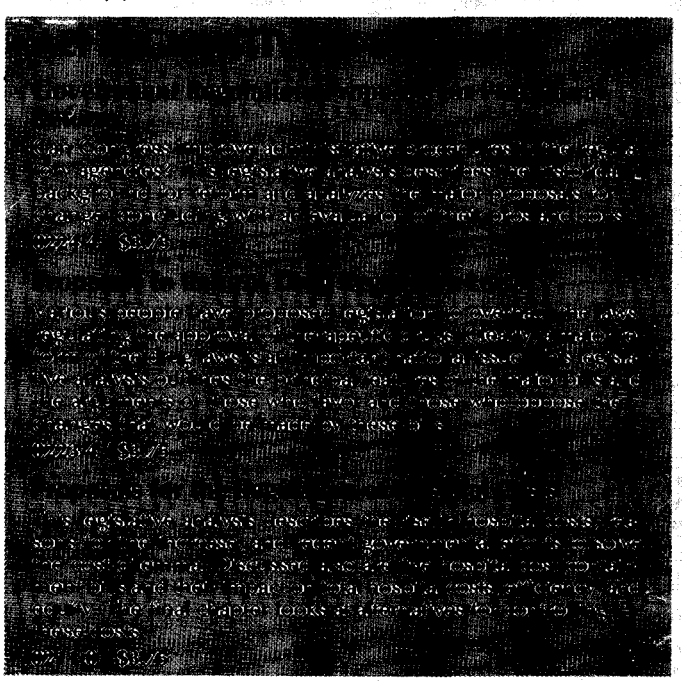
This volume deals with legal and economic issues in the regulation of advertising by government. Is advertising a source of deception or of information, and does it promote competition or monopoly?

2126-3 / $7.25 **2127-1 / Cloth $13.25**

Major Regulatory Initiatives During 1979: The Agencies, the Courts, and the Congress

This special analysis is a survey of *major* regulatory activities at the federal level during 1979. Summarized are the important actions of the independent agencies, those of the executive branch agencies, including administrationwide initiatives, major court decisions, and the highlights of legislative action.

1086-5 / $3.75



To order call toll free **(800) 424-2873** during the hours of 9:00 am to 5:00 pm EST, or write:

American Enterprise Institute
Department 280
1150 Seventeenth Street, N.W., Washington, D.C. 20036

Be sure to include your name and address, the title of the books, and the price. AEI Associates receive a 30% discount. Make checks payable to American Enterprise Institute.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED